TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 12

AMERICAN SURETY COMPANY OF NEW YORK,
PETITIONER,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING
COMPANY ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

PETITION FOR CERTIORARI FILED MARCH 27, 1935.

CERTIORARI GRANTED APRIL 29, 1935.

SUPREME COURT OF THE UNITED STATES

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TRANSCRIPT OF RECORD.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

No. .....

IN THE MATTER OF:

MELTON J. GRAY, trading as GRAY ARTESIAN WELL COMPANY, Bankrupt.

OBJECTIONS of Westinghouse Electric Manufacturing Company, a corporation; National Cast Iron Pipe Company, a corporation; Walter A. Taylor; Frederick Gillmore and Company, a corporation; and A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, to the claim of American Surety Company of New York, a corporation.

Appeal from the District Court of the United States in and for the Northern District of Florida.

In the District Court of the United States for the Northern District of Florida.

In the Matter of:
Melton J. Gray, trading as Gray Artesian Well Company, Bankrupt.

On the 11th day of April, A. D. 1934, the following Directions to Clerk for Making Up Transcript of Record was filed in the above cause:

In the District Court of the United States for the Northern District of Florida.

In the Matter of:
Melton J Gray, trading as Gray Artesian Well Company, Bankrupt.

Objections of Westinghouse Electric Manufacturing Company, a corporation; National Cast Iron Pipe Company, a corporation; Walter A. Taylor; Frederick Gillmore & Company, a corporation; and A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, to the claim of American Surety Company of New York, a corporation.

In making the transcript upon the appeal to the Circuit Court of Appeals herein the Clerk will incorporate therein the following portions of the record:

2 (1) Certificate of the Referee to the District Judge dated December 14, 1933, with all exhibits and also the papers referred to therein and filed therewith which are mentioned below in paragraphs 2 to 8 of this praecipe.

(2) Original proof of claim of American Surety Company.

(3) Objections of Runyan-Cobb Boiler Works to claim of American Surety Company.

(4) Supplemental proof of claim of American Surety Company.

(5) Additional objections of Runyan-Cobb Boiler Works to Supplemental proof of claim of American Surety Company.

(6) Objections of Westinghouse Electric Manufacturing Company and others to supplemental proof of claim of American Surety Company.

(7) Order of Referee dated November 21, 1933, sustaining the objections to the claim of priority of American Surety Company.

(8) Petition of American Surety Company for review by the District Judge of the Referee's order dated November 21, 1933.

(9) Order of the District Judge dated March 8, 1934, sustaining the Referee's order of November 21, 1933.

(10) Petition of American Surety Company for allowance of appeal to the Circuit Court of Appeals.

(11) Assignment of errors on Appeal of American Surety Company.

(12) Order of the District Judge dated April 7, 1934, allowing appeal.

(13) Bond of American Surety Company on appeal.

(14) Citation on appeal.

All other papers will be omitted.

This April 10th, 1934.

CARTER & YONGE,
Attorneys for American
Surety Company.

3 We acknowledge receipt of and copy of the foregoing praecipe indicating the portions of the record to be incorporated in the transcript on appeal on this 11th day of April, 1934. We do not

desire any additional portions of the record incorporated in the transcript and consent that the Clerk proceed at once to make up the record.

WATSON & PASCO &
BROWN,
Attorneys for Westinghouse Electric Manufacturing Company, National Cast Iron Company, Walter A. Taylor and Frederick Gillmore & Company,

FISHER & FISHER,
WM. FISHER,
Attorneys for A. G. Runyan, Randall Bell, and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, T. D. Brux Company, a corporation and Runyan Machine and Boiler Works.

J. McHENRY JONES,
Attorney for W. H. Owens, Trustee in Bankruptcy of the estate of Melton J. Gray, trading as Gray Artesian Well Company.

HOLSBERRY & HOLSBERRY,
Attorneys for H. L. Gray, W. C. Gray, Ray Hardware and Truck Company and Electric Controller and Manufacturing Company.

KNOWLES BROTHERS AGENCY,
By KNOWLES HYER,
V. P. & .....

(1) CERTIFICATE OF REFEREE TO THE DISTRICT JUDGE, as stated in the above directions:

(Title Omitted.)

4 I, Alston Fisher, one of the referees in bankruptcy, of said Court, do hereby certify that in the course of the proceedings in said cause before me the following question arose pertinent to the said proceedings:

That the American Surety Company prior to the adjudication of the bankrupt herein, was surety on a bond given by the bankrupt to the United States in connection with a contract for public work performed by the said bankrupt for the United States at the Naval Air Station, Pensacola, Florida, copies of said contract and said bond being attached hereto and made a part hereof by reference. That said bond was conditioned according to law, which included a condition that the contractor would promptly make payment to all persons furnishing labor and materials for the prosecution of this work under the said contract. The penalty of the bond was $3940.00. The work on the contract was completed but there remained outstanding due and unpaid, to people who had furnished labor and materials for the prosecution of the work the sum of $5677.85, which said sum came within the protection of the penalty and condition of the said bond. That thereafter suit was brought in the District Court of the United States for the Northern District of Florida on said bond and said Surety Company appeared in said suit and paid into Court the penal sum of the said bond which was distributed ratably to the said labor and material men but that said sum was insufficient to pay said claims in full.

That the sum of $2724.23 remained unpaid by the United States to the said bankrupt as balance due

under said contract, which said sum, subsequent to the adjudication of said bankrupt was paid into the hands of W. H. Owens, as trustee of this estate in bankrupt. That subsequent thereto petitions were filed with the undersigned by the various labor and material men, who had furnished labor and materials in the prosecution of the work under said contract, in which petitions the said creditors claimed that they were entitled to a lien upon said fund and to priority of payment therefrom of the balance due them after deducting their pro rata share of the sum paid into Court by the American Surety Company as aforesaid. That the undersigned by order dated September 2, 1933, allowed said petitions to be filed in this proceeding upon the theory that the aforesaid fund, which was paid by the United States to the trustee in bankruptcy came into his hands charged with the rights of the labor and material men, whose labor and materials created said fund. It was the opinion of the undersigned that said creditors were secured by an equitable lien upon the fund. See in re: P. McGarry and Son, 240 Federal 400.

On January 20, 1932, the said American Surety Company filed its proof of claim and on September 15, 1933, its supplemental proof of claim; in which it claimed to be entitled to a lien upon the said fund in the hands of the trustee to secure its repayment of the amount of the penalty of its said bond, heretofore paid into Court and distributed ratably as aforesaid; which said lien was claimed by said company to be prior in dignity to the claims of the labor and material men. That said petition of the American Surety Company for priority was objected to by various labor and material men creditors. After a hearing had thereon before the undersigned, on the 21st day of November, 1933, an order was entered sustaining the said objections to the petition of the American Surety

Company for priority, in which order the claim of the American Surety Company was allowed but held to be inferior to the claims of the aforesaid creditors. Thereafter the said American Surety Company on December 14th, 1933, filed with the undersigned a petition for review by the District Judge, of the aforesaid order denying their said priority of payment.

That in the opinion of the undersigned the order which is hereby subjected to review is correct upon authority of State of Mississippi vs. First National Bank of Greenville, (C. C. A. 5) 66 Fed. 2nd, 9.

There is submitted herewith in addition to the said contract and bond above referred to all papers filed with the undersigned pertinent to this proceeding, consisting of the following:

Original claim of American Surety Company.

Objections to claim by Runyan-Cobb Boiler Works.

Supplemental claim of American Surety Company.

Additional objections of Runyan-Cobb to Supplemental claim of American Surety Company.

Objections of Westinghouse Electric Mfg. Co., National Cast Iron Pipe Company, Walter A. Taylor, and Frederick Gillmore & Company to supplemental claim of American Surety Company.

Order of Referee sustaining objections to claim of American Surety Company.

Petition for review by American Surety Company.

And the said question is certified to the Judge for his opinion thereon.

Dated at Pensacola, in said District, this 14th day of December, A. D. 1933.

ALSTON FISHER,
Referee in Bankruptcy.

(And attached thereto the following contract and bond):

7 Copy.

Standard Form No. 23. NOy-934
Approved by the President (Spec. 6288.)
Nov. 19, 1926.

Standard Government Form of Contract.
(Construction.)

Navy Department.
(Bureau of Yards and Docks.)
(Department.)

Gray Artesian Well Company.
(Contractor.)

Contract for Well, Amount $13,133.36.
Place, Naval Air Station, Pensacola, Florida.

7½ Contract for Construction.

This Contract, entered into this 8th day of November, 1930, by the United States of America, hereinafter called the Government, represented by the contracting officer executing this contract, and Melton J. Gray, an individual trading as Gray Artesian Well Company of the City of Pensacola, in the State of Florida, hereinafter called the contractor, witnesseth, that the parties hereto do mutually agree as follows:

Article 1. Statement of Work.—The contractor shall furnish all labor and materials, and perform all work

required for sinking a well, constructing a pump enclosure, and installing deep well pumping equipment therein, at the Naval Air Station, Pensacola, Florida, as contemplated by Item 1, paragraph 6-02, of Specification No. 6288, based on furnishing a Pomona pump.

for the consideration of Thirteen thousand one hundred thirty-three dollars and thirty-six cents ($13,133.36),

in strict accordance with the specifications, schedules, and drawings, all of which are made a part hereof and designated as follows: Said Specification No. 6288, the General Provisions, drawings and standard specifications mentioned therein, the Instructions Relative to Factory Inspection mentioned in said General Provisions; bulletin No. 15, curve sheet and description of the Pomona Turbine Pumping Unit, specification of the motor, dimension sheet of the pump head, and sectional view of the deep well pump.

The work shall be commenced within 7 calendar days after date of receipt of notice to proceed and shall be completed within 120 calendar days from the date of receipt of notice to proceed.

8 Article 2. Specifications and Drawings.—The contractor shall keep on the work a copy of the drawings and specifications and shall at all times give the contracting officer access thereto. Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications shall be of like effect as if shown or mentioned in both. In case of difference between drawings and specifications, the specifications shall govern. In any case of discrepancy in the figures or drawings, the matter shall be immediately submitted to the contracting officer, without whose

decision said discrepancy shall not be adjusted by the contractor, save only at his own risk and expense. The contracting officer shall furnish from time to time such detail drawings and other information as he may consider necessary, unless otherwise provided. Upon completion of the contract the work shall be delivered complete and undamaged.

Article 3. Changes.—The contracting officer may at any time, by a written order, and without notice to the sureties, make changes in the drawings and (or) specifications of this contract and within the general scope thereof. If such changes cause an increase or decrease in the amount due under this contract, or in the time required for its performance, an equitable adjustment shall be made and the contract shall be modified in writing accordingly. No change involving an estimated increase or decrease of more than Five Hundred Dollars shall be ordered unless approved in writing by the head of the department or his duly authorized representative. Any claim for adjustment under this article must be asserted within ten days from the date the change is ordered, unless the contracting officer shall for proper cause extend such time, and if the parties cannot agree upon the adjustment the dispute shall be determined as provided in Article 15 hereof. But nothing provided in this article shall excuse the contractor from proceeding with the prosecution of the work so changed.

Article 4. Changed conditions.—Should the contractor encounter, or the Government discover, during the progress of the work, subsurface and (or) latent conditions at the site materialy differing from those shown on the drawings or indicated in the specifications, the attention of the contracting officer shall be called immediately to such conditions before they are disturbed. The contracting officer shall thereupon promptly investigate the conditions, and if he finds

that they materially differ from those shown on the drawings or indicated in the specifications, he shall at once, with the written approval of the head of the department or his representative, make such changes in the drawings and (or) specifications as he may find necessary, and any increase or decrease of cost and (or) difference in time resulting from such changes shall be adjusted as provided in Article 3 of this contract.

Article 5. Extras.—Except as otherwise herein provided, no charge for any extra work or material will be allowed unless the same has been ordered in writing by the contracting officer and the price stated in such order.

Article 6. Inspection.—(a) All material and workman ship (if not otherwise designated by the specifications) shall be subject to inspection, examination, and test by Government inspectors at any and all times during the manufacture and (or) construction and at any and all places where such manufacture and (or) construction are carried on. The government shall have the right to reject defective material and workmanship or require its correction. Rejected workmanship shall be satisfactorily corrected and rejected material shall be satisfactorily replaced with proper material without charge therefor, and the contractor shall promptly segregate and remove the same from the premises.

9 (b) The contractor shall furnish promptly without additional charge, all reasonable facilities, labor, and materials necessary for the safe and convenient inspection and test that may be required by the inspection. All inspection and tests by the Government shall be performed in such manner as not to unnecessarily delay the work. Special, full size, and performance tests shall be as described in

the specifications. The contractor shall be charged with any additional cost of inspection when material and workmanship is not ready at the time inspection is requested by the contractor.

(c) Should it be considered necessary or advisable by the Government at any time before final acceptance of the entire work to make an examination of work already completed, by removing or tearing out same, the contractor shall on request promptly furnish all necessary facilities, labor, and material. If such work is found to be defective in any material respect, due to fault of the contractor or his subcontractors, he shall defray all the expenses of such examination and of satisfactory reconstruction. If, however, such work is found to meet the requirements of the contract, the actual cost of labor and material necessarily involved in the examination and replacement, plus 15 per cent, shall be allowed the contractor and he shall, in addition, if completion of the work has been delayed thereby, be granted a suitable extension of time on account of the additional work involved.

(d) Inspection of material and finished articles to be incorporated in the work at the site shall be made at the place of production, manufacture, or shipment, whenever the quantity justifies it, unless otherwise stated in the specifications; and such inspection and acceptance, unless otherwise stated in the specifications, shall be final, except as regards latent defects, departures from specific requirements of the contract and the specifications and drawings made a part thereof, damage or loss in transit, fraud, or such gross mistakes as amount to fraud. Subject to the requirements contained in the preceding sentence, the inspection of material and workmanship for final acceptance as a whole or in part shall be made at the site.

Article 7.—Materials and workmanship.—Unless otherwise specifically provided for in the specifications, all workmanship, equipment, materials, and articles incorporated in the work covered by this contract are to be of the best grade of their respective kinds for the purpose. Where equipment, materials, or articles are referred to in the specifications as "equal to" any particular standard, the contracting officer shall decide the question of equality. The contractor shall furnish to the contracting officer for his approval the name of the manufacturer of machinery, mechanical and other equipment which he contemplates installing, together with their performance capacities and other pertinent information. When required by the specifications, or when called for by the contracting officer, the contractor shall furnish the contracting officer for approval full information concerning the materials or articles which he contemplates incorporating in the work. Samples of materials shall be submitted for approval when so directed. Machinery, equipment, materials, and articles installed or used without such approval shall be at the risk of subsequent rejection. The contracting officer may require the contractor to dismiss from the work such employee as the contracting officer deems incompetent, careless, insubordinate, or otherwise objectionable.

Article 8. Superintendence by contractor. —The contractor shall give his personal superintendence to the work or have a competent foreman or superintendent, satisfactory to the contracting officer, on the work at all times during progress, with authority to act for him.

Article 9. Delays—Damages.—If the contractor refuses or fails to prosecute the work, or any separable part thereof, with such diligence as will insure its completion within the time specified in Article 1, or any extension thereof, or fails to complete said work

within such time, the Government may, by written notice to the contractor, terminate his right to proceed with the work or such part of the work as to which there has been delay. In such event, the Government may take over the work and prosecute the same to completion by contract or otherwise, and the contractor and his sureties shall be liable to the Government for any excess cost occasioned the Government thereby. If the contractor's right to proceed is so terminated, the Government may take possession of and utilize in completing the work such materials, appliances and plant as may be on the site of the work and necessary therefor. If the Government does not terminate the right of the contractor to proceed, the contractor shall continue the work, in which event the actual damages for the delay will be impossible to determine and in lieu thereof the contractor shall pay to the Government as fixed, agreed, and liquidated damages for each calendar day of delay until the work is completed or accepted the amount as set forth in the specifications or accompanying papers and the contractor and his sureties shall be liable for the amount thereof: Provided, that the right of the contractor to proceed shall not be terminated or the contractor charged with liquidated damages because of any delays in the completion of the work due to unforeseeable causes beyond the control and without the fault or negligence of the contractor, including, but not restricted to, acts of God, or of the public enemy, acts of the Government, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, and unusually severe weather or delays of subcontractors due to such causes: Provided Further, that the contractor shall within ten days from the beginning of any such delay notify the contracting officer in writing of the causes of delay, who shall ascertain the facts and the extent of the delay, and his findings of facts thereon shall be final and conclusive on the parties hereto, subject only to appeal, within thirty

days, by the contractor to the head of the department concerned, whose decision on such appeal as to the facts of delay shall be final and conclusive on the parties hereto.

Article 10. Permits and care of work.—The contractor shall, without additional expense to the Government, obtain all required licenses and permits and be responsible for all damages to persons or property that occur as a result of his fault or negligence in connection with the prosecution of the work, and shall be responsible for the proper care and protection of all materials delivered and work performed until completion and final acceptance.

Article 11. Eight-hour law—Convict labor.—(a) No laborer or mechanic doing any part of the work contemplated by this contract, in the employ of the contractor or any subcontractor contracting for any part of said work contemplated, shall be required or permitted to work more than eight hours in any one calendar day upon such work at the site thereof. For each violation of the requirements of this article a penalty of five dollars shall be imposed upon the contractor for each laborer or mechanic for every calendar day in which such employee is required or permitted to labor more than eight hours upon said work, and all penalties thus imposed shall be withheld for the use and benefit of the Government: Provided, That this stipulation shall be subject in all respects to the exceptions and provisions of the act of June 19, 1912 (37 Stat. 137), relating to hours of labor.

(b) The contractor shall not employ any person undergoing sentence of imprisonment at hard labor.

Article 12. Covenant against contingent fees.—The contractor warrants that he has not employed any

person to solicit or secure this contract upon any agreement for a commission, percentage, brokerage, or contingent fee. Breach of this warranty shall give the Government the right to terminate the contract, or, in its discretion, to deduct from the contract price or consideration the amount of such commission, percentage, brokerage, or contingent fees. This warranty shall not apply to commissions payable by contractors upon contracts or sales secured or made through bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business.

Article 13.—Other contracts.—The Government may award other contracts for additional work, and the contractor shall fully cooperate with such other contractors and carefully fit his own work to that provided under other contracts as may be directed by the contracting officer. The contractor shall not commit or permit any act which will interfere with the performance of work by any other contractor.

Article 14. Officials not to benefit.—No Member of or Delegate to Congress, or Resident Commissioner, shall be admitted to any share or part of this contract or to any benefit that may arise therefrom, but this provision shall not be construed to extend to this contract if made with a corporation for its general benefit.

Article 15. Disputes.—Except as otherwise specifically provided in this contract, all disputes concerning questions of fact arising under this contract shall be decided by the contracting officer or his duly authorized representative, subject to written appeal by the contractor within thirty days to the head of the department concerned, whose decision shall be final and conclusive upon the parties thereto as to such questions of fact. In the meantime the contractor shall diligently proceed with the work as directed.

Article 16. Payments to contractors.—(a) Unless otherwise provided in the specifications, partial payments will be made as the work progresses at the end of each calendar month, or as soon thereafter as practicable, on estimates made and approved by the contracting officer. In preparing estimates the material delivered on the site and preparatory work done may be taken into consideration.

(b) In making such partial payments there shall be retained 10 per cent on the estimated amount until final completion and acceptance of all work covered by the contract: Provided, however, That the contracting officer, at any time after 50 per cent of the work has been completed, if he finds that satisfactory progress is being made, may make any of the remaining partial payments in full: And provided further, That on completion and acceptance of each separate building, vessel, public work, or other division of the contract, on which the price is stated separately in the contract, payment may be made in full, including retained percentages thereon, less authorized deductions.

(c) All material and work covered by partial payments made shall thereupon become the sole property of the Government, but this provision shall not be construed as relieving the contractor from the sole responsibility for the care and protection of materials and work upon which payments have been made or the restoration of any damaged work, or as a waiver of the right of the Government to require the fulfillment of all of the terms of the contract.

(d) Upon completion and acceptance of all work required hereunder, the amount due the contractor under this contract will be paid upon the presentation of a properly executed and duly certified voucher

therefor, after the contractor shall have furnished the Government with a release, if required, of all claims against the Government arising under and by virtue of this contract, other than such claims, if any, as may be specifically excepted by the contractor from the operation of the release in stated amounts to be set forth therein.

Article 17. Additional security.—Should any surety upon the bond for the performance of this contract become unacceptable to the Government, the contractor must promptly furnish such additional security as may be required from time to time to protect the interest of the Government and of persons supplying labor or materials in the prosecution of the work contemplated by the contract.

Article 18. Definitions.—(a) The term "head of department" as used herein shall mean the head of the executive department or independent establishment involved, and "his representative" means any person authorized to act for him other than the contracting officer.

(b) The term "contracting officer" as used herein shall include his duly appointed successor or his duly authorized representative.

Article 19. Alterations.—The following changes were made in this contract before it was signed by the parties hereto:

In Article 18 (a), the words "other than the contracting officer" have been deleted.

Article 20. Patents.—The contractor shall hold and save the Government, its officers, agents, servants, and employees, harmless from liability of any nature or kind for or on account of the use of any patented or unpatented invention, article, or appliance furnished

or used in the performance of this contract, excepting patented articles required by the Government in its specifications, the use of which the contractor does not control.

In Witness Whereof, the parties hereto have executed this contract as of the day and year first above written.

THE UNITED STATES OF AMERICA
By A. L. PARSONS,
Chief of the Bureau of Yards and Docks Acting under the direction of the Secretary of the Navy. (Official Title)
By GRAY ARTESIAN WELL CO.,
By M. J. GRAY,
Contractor.
Pensacola, Florida, (Business address.)

Two witnesses:
W. J. KELLY,
JOS. S. RIERA.

(O. K. as to Form and Execution D. F. S.)

13 Copy.

Standard Form No. 25 Approved by the President Nov. 19, 1926.

6288

Standard Government Form of Performance Bond
(Construction or Supply)

Know All Men By These Presents, That we, Melton I. Gray, an individual trading as Gray Artesian Well Company, (See Instructions 4, 5 and 7) as Principal,

and American Surety Company of New York as Surety, (See Instructions 2, 3, 4, and 7) are held and firmly bound unto the United States of America, hereinafter called the Government, in the penal sum of Three Thousand Nine Hundred Forty ($3,940.00) Dollars lawful money of the United States, for the payment of which sum well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally, firmly by these presents.

The Condition Of This Obligation Is Such, that whereas the principal entered into a certain contract, hereto attached, with the Government, dated November 8th, 1930, for sinking a well, constructing a pump enclosure, and installing deep well pumping equipment therein, at the Naval Air Station, Pensacola, Fla., in accordance with Specification No. 6288.

Now Therefore, If the principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions and agreements of any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, and if said contract is for the construction or repair of a public building or a public work within the meaning of the act of August 13, 1894, as amended by act of February 25, 1905, shall promptly make payment to all persons supplying the principal with labor and materials in the prosecution of the work provided for in said contract, and any such authorized extension or modification thereof, then, this obligation to be void; otherwise to remain in full force and virtue.

In Witness Whereof, the above-bounden parties have executed this instrument under their several seals this 15th day of November, 1930, the name and corporate seal of each corporate party being hereto affixed and these presents duly signed by the undersigned representative, pursuant to authority of its governing body.

GRAY ARTESIAN WELL COMPANY,
By M. J. GRAY,
(Seal) (Individual principal) Sole Owner.
Pensacola, Fla. (Business address).

AMERICAN SURETY COMPANY OF NEW YORK,
(Corporate Surety).
By J. V. RIERA,
Atty-in-Fact New York, N. Y. (Business Address.)

In presence of:
W. J. KELLY,
Pensacola, Fla. (Address).
JOS. S. RIERA,
Pensacola, Fla. (Address.)

Treasury Department Office of the Secretary Section of Surety Bonds Division of Appointments Dec. 9, 1930.

Examined and approved as to the within corporate surety.

Attest:
J. E. HARPER,
Chief, Division of Appointments.
Attest:
.....

Navy Department Approved:
D. F. SELLERS,
Judge Advocate General.

The rate of premium on this bond is $15.00 per thousand.

Total amount of premium charged, $196.99.

(The amount must be filled in by corporate surety).

15 Copy.

Received G. A. O. May 5, 1931.

May 4, 1934.

In Reply address The Bureau of Yards and Docks And Refer To No. NOy-934

Navy Department Bureau of Yards and Docks Washington, D. C.

Change "A".

Subject: Contract NOy-934 (Specification No. 6288) for well, Naval Air Station, Pensacola, Fla.

Gentlemen:

With reference to your contract NOy-934 (Specification No. 6288), dated November 8, 1930, for a well at the Naval Air Station, Pensacola, Fla., you are informed that, owing to the following-mentioned changes, authorized during the performance of the work, namely, that you—

(a) Provide and install pump stand and removable split cover; provide additional 10-inch gate valve and

move chack valve; provide screen or 3/8-inch thickness instead of 1/4-inch; omit 6-inch gravel fill pipes and liquid marine cement mortar; provide spacers for 2-inch wash pipes; and substitute slip ring or wound rotor motor and suitable starting device for squirrel cage motor and control equipment; and

(b) Install an additional 10-inch hub gate valve; raise the elevation of floor or pump house 4 inches; increase the depth of well below top of concrete slab to 139 feet; and install 1 foot 9 inches additional 32-inch casing,

All as directed by the officer in charge.

the contract price, pursuant to the provisions of Article 3 of the contract, is hereby increased for item (a) by the sum of $1,585.78, and increased for item (b) by $523.86, making a total increase of $2,109.64, payable from appropriation No. 7X289, "Naval Air Station, Pensacola, Fla.", subhead No. 3, "Improvement of water system", (Allotments No. 7X289-3-1A and No. 7X289-3-1B), and the time prescribed for the completion of the contract is hereby extended, on account of the work covered by item (a) seventy-eight (78) calendar days, and on account of the work covered by item (b) six (6) calendar days, making a total extension of eighty-four (84) calendar days.

Very truly yours,

A. L. PARSONS,

Chief of Bureau.

Gray Artesian Well Company, Pensacola, Fla.

C—The Comptroller General,

CC—Bureau of Supplies and Accounts.

CC—Public Works Officer, Naval Air Station, Pensacola, Fla.

CC—American Surety Company of New York, New York, N. Y.

CC—Bureau Contract.

16 In reply address The Bureau of Yards and Docks and refer to No. NOy-934.

Navy Department Bureau of Yards and Docks Washington, D. C.

Change "B".

Jul. 10, 1931.

Subject: Contract NOy-934 (Specification No. 6288) for well, Naval Air Station, Pensacola, Fla.

Gentlemen:

With reference to your contract NOy-934 (Specification No. 6288), dated November 8, 1930, for a well at the Naval Air Station, Pensacola, Fla., you are informed that, owing to the following-mentioned change, heretofore authorized, in the work under said contract, namely, that you—

Replace all flanged pump and discharge pump suction connections that are below the top of the screens with screwed sleeve type connections, as directed by the officer in charge,

the time for the completion of the contract is hereby, pursuant to Article 3 of the contract, further extended thirty (30) calendar days, without change in price.

Very truly yours,

A. L. PARSONS,

Chief of Bureau.

Gray Artesian Well Company, Pensacola, Fla.

C—The Comptroller General,

CC—Bureau of Supplies and Accounts.

CC—Public Works Officer, Naval Air Station, Pensacola, Fla.

CC—American Surety Company of New York, New York, N. Y.

CC—Bureau contract.

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17 (2) PROOF OF CLAIM OF AMERICAN SURETY COMPANY.

(Title Omitted:)

State of New York,
County of New York, ss.

1. At the Borough of Manhattan, in the City, County and State of New York, on the 18th day of January, 1932, came Charles W. Goetchius of the Borough of Brooklyn, City of New York, State of New York, and made oath and says: That he is the Treasurer of the American Surety Company of New York, a corporation organized and existing under and by virtue of the laws of the State of New York, and having its Office and principal place of business at No. 100 Broadway, Borough of Manhattan, City, County and State of New York, and that he is duly authorized to make this proof of claim.

2. That the said M. J. Gray, trading as Gray Artesian Well Company, the person against whom a petition for an adjudication in bankruptcy was filed, was at and before the filing of said petition and still is, justly and truly indebted to said American Surety Company of New York in the sum of Nine Hundred Thirty and 19/100 Dollars ($930.19) and for such other sum or sums as said American Surety Company of New York may be compelled to pay by reason of the following facts, which are the consideration of said debt.

3. That on or about November 2nd, 1922, said M. J. Gray, trading as Gray Artesian Well Company, executed and delivered to said American Surety Company of New York his general agreement of indemnity, copy whereof is hereto annexed, marked Exhibit "A" and made a part hereof.

18 4. That relying upon the security of said agreement of indemnity said American Surety Company of New York executed, as surety, bond of said M. J. Gray, trading as Gray Artesian Well Company, dated on or about April 8th, 1929 in the amount of Five Hundred Dollars ($500.00) unto the American National Bank, Pensacola, Florida, as security for the issuance of a duplicate of a certified check dated on or about March 9th, 1929, numbered 3157, payable to the Mayor and Board of Aldermen of the Town of Forest, Mississippi in the amount of Five Hundred Dollars ($500.00) made by said M. J. Gray and drawn on said American National Bank, Pensacola, Florida.

5. That relying upon the security of said agreement of indemnity said American Surety Company of New York executed, as surety, bond of said M. J. Gray, trading as Gray Artesian Well Company, dated on or about November 21st, 1930, in the amount of

Two Thousand Four Hundred Seventy Five and no/-100 Dollars ($2475.00) unto the City of Bainbridge, Georgia, securing performance of contract dated on or about November 21st, 1930 with said City of Bainbridge, Georgia, for drilling a well for said City.

6. That on or about November 15th, 1930 said M. J. Gray, trading as Gray Artesian Well Company, made written application to said American Surety Company of New York for its suretyship on bond of said M. J. Gray, trading as aforesaid, in the amount of Three Thousand Nine Hundred Forty and no/100 Dollars ($3940.00) unto the United States of America, securing performance of contract for drilling a well at the Naval Air Station, Pensacola, Florida; that in conjunction with such application said M. J. Gray, trading as aforesaid, executed and delivered to said American Surety Company of New York his agreement of indemnity, copy whereof is hereto annexed, marked Exhibit "B" and made a part hereof.

19 9. That relying upon the security of said agreement of indemnity said American Surety Company of New York executed, as surety, bond of said M. J. Gray, trading aforesaid, dated on or about November 15th, 1930 in the amount of Three Thousand Nine Hundred Forty and no/100 Dollars ($3,-940.00) unto said United States of America securing performance of said contract for drilling a well at the Naval Air Station, Pensacola, Florida.

10. That competent, written legal evidence of the discharge of said American Surety Company of New York from its liability by reason of its suretyship on the aforesaid bonds has not been furnished to said American Surety Company of New York.

11. That the contract of said M. J. Gray, trading as aforesaid, with the said United States of America

for the drilling of a well at the Naval Air Station, Pensacola, Florida, was completed on or about July , 1931, and that said contract was accepted by said United States of America. That subsequent to the completion of said contract, the following named persons, firms and corporations filed their claims with said American Surety Company of New York as surety for said M. J. Gray, trading as aforesaid, on bond referred to in paragraph nine herein, for payment of the amounts set opposite their names due for labor or materials furnished to said M. J. Gray, trading as aforesaid, on said contract.

Wright Oil Company	$ 73.32
Runyan Cobb Boiler Works	2951.94
Runyan Machine & Boiler Works	49.74
F. D. Brux Company	111.65
Standard Sanitary Manufacturing Co.	110.14
Ferris-Lee Lumber Company	130.40
Woodward Electric Company	205.65
Westinghouse Electric & Mfg. Co.	374.64
Roquemore Gravel Company	60.62
National Cast Iron Pipe Company	435.31
Frederick Gilmore & Company	57.46
Ray Hardware & Truck Company	85.02
Electric Controller & Mfg. Co.	480.60
H. L. Gray	200.00
L. M. Gray	57.17
W. C. Gray	431.55
	$5815.41

20 12. That on or about January 6th, 1932, said American Surety Company of New York, pursuant to the terms of its bonds as aforesaid, paid to Standard Sanitary Manufacturing Company the sum of One Hundred Ten and 14/100 Dollars ($110.14), to the Westinghouse Electric & Manufactur-

ing Company the sum of Three Hundred Seventy Four and 64/100 Dollars ($374.64), and to the National Cast Iron Pipe Company the sum of Four Hundred Thirty five and 31/100 Dollars ($435.31) in satisfaction of their claims against said M. J. Gray, trading as aforesaid, for materials furnished to said M. J. Gray on his contract with said United States of America as aforesaid.

13. That in consequence of such payments by said American Surety Company of New York, there is now due said American Surety Company of New York from said M. J. Gray, trading as aforesaid, the sum of Nine Hundred Thirty and 19/100 Dollars ($930.19).

14. That there is also due said American Surety Company of New York from said M. J. Gray, trading as aforesaid, such further sum or sums as may be necessary to indemnify said American Surety Company of New York and save it harmless from and against every claim, demand, liability, cost, charge, counsel fee, expense, suit, order, judgment and adjudication whatsoever, pursuant to the terms of the agreements of indemnity hereinbefore referred to.

15. That no part of said debt has been paid; that there are no setoffs or counterclaims thereto; that no note has been taken or judgment rendered on said debt; and that said American Surety Company of New York has not, nor has any person by its order or to the knowledge or belief of deponent, for the use of said American Surety Company of New York, had or received any manner of security for said debt whatever, except as herein stated.

21

CHARLES W. GOETCHIUS,
Treasurer of American Surety
Company of New York.

Sworn and subscribed to before me this ..... day of January, 1932.

HORACE P. HOLLISTER,
(Seal) Notary Public, Westchester County Certificate Filed in New York and Kings Counties New York County No. 255, Register's No. 3-H-114, Kings County No. 20, Register's No. 3127, My commission expires March 30, 1933.

(Attached thereto the following):

(EXHIBIT "A".)

Rec'd Nov. 8, 1922 S. B.

American Surety Company of New York.

Capital $5,000,000.

General Contract of Indemnity.

Credit Division Nov. 6, 1922 J. S. Flynn.

(Pictured) Company's Office Building, 100 Broadway N. Y.

Whereas, the undersigned or one or more of them (hereinafter called the Indemnitor) have heretofore required, and may hereafter require suretyship upon certain obligations of suretyship on behalf of the undersigned, or of one or more of them, or of some other person or corporation, and have applied, and one or more of them may hereafter apply to the American

Surety Company of New York (hereinafter called the surety) to execute such instruments, as Surety:

Therefore, the undersigned do hereby, jointly and severally, undertake and agree:

First—That they will pay the Surety at its office, 100 Broadway, in the City of New York, on the day of the date of each such obligation, a premium or charge, for executing such obligation and continuing the same in force for one year, and will thereafter pay a like sum, annually, in advance, until the Surety shall be discharged and released from any and all responsibility upon each such obligation and until the Indemnitor shall serve upon the Surety competent, written, legal evidence of its final discharge from each such obligation and all liability by reason thereof, and the expiration, without appeal or proceedings to review, of the time to appeal from or review any adjudication or determination, directly or indirectly fixing or discharging such liability.

Such premium or charge for each such obligation shall be in accordance with the regular schedule rates published by the Surety.

Second—That the Indemnitor will perform all the conditions of each said bond, and any and all renewals and extensions thereof, and will at all times indemnify and save the Surety harmless from and against every claim, demand, liability, cost, charge, counsel fee (including fees of special counsel whenever by the Surety deemed necessary) expense, suit, order, judgment and adjudication whatsoever, and will place the Surety in funds to meet the same before it shall be required to make payment, and in case the Indemnitor requests the Surety to join in the prosecution or defense of any legal proceeding, the Indemnitor will, on demand of

the Surety, place it in funds sufficient to defray all expenses and all judgments that may be rendered therein. The Indemnitor will not ask or require the Surety to remove or join in any application for the removal of any proceeding from a State Court to a Federal Court in any state where such action would in any way affect the Surety's right to transact business.

Third—That upon the making of any demand, or the giving of any notice, or the institution of any proceeding preliminery to determining or fixing any liability which the Surety may be called upon to discharge by reason of any such suretyship, and any and all renewals and extensions thereof, the Indemnitor will immediately notify the Surety thereof in writing at its said office.

Fourth—That in the event of the Surety deeming it advisable, or of the Indemnitor requesting the Surety, to prosecute or defend or take part in any action, suit, or proceeding, appeal or writ of error, the Indemnitor will, on being advised of the Surety's intent so to do, or on the Indemnitor making such request, place the Surety in possession of funds or securities, approved by it, sufficient to defray any costs, charges or expenses which it may incur in so doing, and to discharge any liability, order, judgment or adjudication which may result therefrom, or from its said suretyship.

Fifth—That the Indemnitor will, on the request of the Surety, procure the Discharge of the Surety from any such suretyship, and all liability by reason thereof.

Sixth—That the Surety shall have every right and remedy which a personal surety without compensation would have, including the right to secure its discharge from its suretyship, and should it make payment thereunder, shall have every right and remedy of the Indemnitor for the recovery of the same.

Seventh—That the voucher or other evidence of any payment made by the Surety by reason of such suretyship, shall have or any renewal or extension thereof, shall be prima facie evidence of such payment and the propriety thereof, and of the liability of the Indemnitor therefor to the Surety.

Eighth—That the Surety also looks to and relies upon the property of the Indemnitor, and the income and earnings thereof, and shall also, at all times have the right to rely upon, look to, and follow and recover out of the property which the Indemnitor now has or may hereafter have, and the income and earnings thereof, for anything due or to become due it, the Surety, under this agreement, such suretyship having been by the Surety entered into for the special benefit of the Indemnitor and the special benefit and protection of the Indemnitor's property, its income and earnings.

23 Ninth—That this agreement shall not, nor shall acceptance by the Surety of payment for its suretyship, nor agreement to accept, nor acceptance by it at any time of other surety, nor assent by it to any act of the principal named in any suretyship obligation, or of any person acting on behalf of the principal, or of the Indemnitor, in any way abridge, defer or limit its right to be subrogated to any right or remedy, nor limit nor abridge any right or remedy which the Surety otherwise might or may have, acquire, exercise or enforce, nor create any liability on the part of the Surety which would not exist were this agreement not executed.

Tenth—That the liability of the Indemnitor hereunder shall not in any wise be discharged by any alteration, extension or modification of the suretyship under any such obligation herein, which shall have been re-

quested or assented to by the principal in said obligation and by the Surety; but on the contrary, all the terms of this agreement shall apply to any and all such alterations and modifications.

Eleventh—The Indemnitor hereby further agrees in the event of being unable to complete or carry on any contract covered by any suretyship of the said Surety, executed hereunder, to assign and does hereby assign to the said Surety, all right, title and interest of the Indemnitor in and to all the tools, plant, equipment and materials of every nature and description that the Indemnitor may have upon the work provided for in the contract covered by said suretyship, or in, on or about the site thereof, including as well materials purchased for or chargeable to such contracts, which may be in process of construction, on storage elsewhere, or in transportation to said site; and the Indemnitor further agrees to assign and hereby does assign to the said Surety, all the former's rights in and to all sub-contracts which may be entered into, and the materials embraced therein appertaining to said contract; and the Indemnitor further agrees in the event of any breach or default on his part in any of the provisions of any contract covered by the suretyship of the said Surety executed in pursuance of such contract, that the said Surety, as Surety, shall be subrogated to all the rights that may be due and payable at the and properties of the Indemnitor in such contracts, and that deferred payments and any and all moneys and securities that may be due and payable at the time of such default, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract, shall be credited for any claim that may be made upon the said Surety by reason of its suretyship as aforesaid.

Twelfth—All the terms and conditions of this agreement shall stand for the protection of any co-surety,

any reinsuring company, or any other surety procured by the American Surety Company of New York above named, whether the American Surety Company of New York does or does not execute or retain any portion of any such obligation.

Thirteenth—That the Indemnitor renders the following statement of his financial condition at the close of business on the 2nd day of November, 1922:

24 Financial Statement.

(In the case of a firm use additional separate financial statement for each partner.)

(On Margin: If the required information is not given in response to the foregoing questions, it will be necessary to return this blank for completion. The answers will be treated as strictly confidential.)

Assets.

Real Estate as per Schedule A ..... (Schedule A annexed should be prepared and should describe in detail each piece of real estate owned. State its cost price, its present value, and the nature and amount of encumbrances thereon. The amount should be here entered at its present value without deduction for encumbrances, the amount of such encumbrances being included in the statement of liabilities contra.)	6,750.00
Plant at cost, replacement value $100,000.00 carried at cost, depreciated 10% yearly. Less allowance for depreciation.....	34,000.00
10 drilling outfits—(3 hydraulic rotary outfits, 2 combination (K. D.) for rock,	

other 2 Star Rock drilling outfits, 1 cyclone rock outfit, 1 small rotary outfit, 1 jetting outfit).

(The above in margin stating: "State here briefly the general nature of the plant." "Patents and good will should not be included therein.")

Cash on hand	
Cash in American National Bank of Pensacola	500.00
(Payment from U. S. in mail in route to bank)	2,500.00
Stocks, bonds and similar securities at present market value, as per Schedule B, (Schedule B, annexed should be prepared showing in detail the stocks, bonds and securities owned).	
Notes, and accounts not otherwise included herein secured by lien on real estate.	
Notes and accounts not otherwise included herein secured by collateral.	
Notes and accounts unsecured not otherwise included herein.	
Stock of merchandise at cost. (State generally nature of stock, such as dry goods, groceries, etc.)—Pipe	4,700.00
Due for work completed on unfinished contracts as per Schedule C	5,000.00

(Schedule C annexed should be prepared, describing in brief each contract unfinished, the amount of the contract price, the amount of the work completed, the amount paid on account, and the amount earned but not yet paid.)

Stock unmanufactured and partially manufactured at cost	

(State here the nature thereof.)

Patents	
(State here in a general way the nature of the patents.)	
Good will	
(State here the nature of the good will.)	
Total Assets	53,450.00

Liabilities.

Debts secured by lien on real estate as per Schedule A	None
Debts, including notes, secured by collateral	
Debts due the United States.....	
Debts due any State, county or municipality	
Debts due to laborers or employees.....	
Debts, including notes, unsecured and not yet due	500.00
Debts, including notes, unsecured and past due	
Reserves, if any	
(State here generally the nature of the reserves.)	
*Net Surplus	52,950.00

†Due partners, as follows:

.....

.....

*To be used by an individual only.
†To be used by a co-partnership only.

26 ‡To be used by a corporation only:

‡Undivided profits .....
‡Surplus .....
‡Capital Stock, divided into .... shares of $....., each .....

Total Liabilities 53,450.00

Note:—Items inapplicable may be left blank. In the case of a co-partnership, similar financial statement from each individual partner should be obtained if the amount of credit required exceeds that warranted by the firm's statement.

Schedule A.

House & Lot—314 S. Alcaniz St., Pensacola, Fla., cost $3000 in 1916—Present value at lease	$5,000.00
160 A. in Jackson Co., Fla. (cut-over land)	1,000.00
5 lots in Cottondale, Fla. (just sold one similar lot at $160.00)	750.00
	6,750.00

Schedule B.

.....

Schedule C.

U. S. Naval Air Station—	earned, not paid	$1,250.00
City of Eufaula, Ala.—	earned, not paid	600.00
O. B. Andrews Co.—	earned, not paid	1,000.00
Muscogee Co. Alms House—	earned, not paid	1,000.00
Brookhaven, Miss.		1,150.00
		5,000.00

27 The Indemnitor hereby certifies that each statement hereinbefore contained is true and

that this statement is made for the purpose of inducing the American Surety Company of New York to execute certain bonds or undertakings without demanding collateral security for the full amount thereof.

Signed and sealed ..... Nov. 2, 1922.

M. J. GRAY, doing business as
Gray Artesian Well Co.

Signed, sealed and delivered in the presence of:
(Name indecipherable.)

(Acknowledge signature on next page.)

(Individual Acknowledgment.)

State of Ga.,
County of Fulton, ss:

On this 2nd day of Nov., 1922, before me personally came M. J. Gray, to me known and known to me to be the person described in and who executed the foregoing instrument, and he thereupon acknowledged to me that he executed the same.

E. G. SNOW,
Notary Public, Fulton Co., Ga.

Form C. 20 M 1-21.

American Surety Company of New York.

Capital $5,000,000.

(Pictured) Company's Home Office Building.

Agency at Pensacola, State of Fla.

Name K. Bros. Agcy., Agent or Attorney.
Branch Office at .....
Bond No. 294840-D.
Sub. Ag'y Bond No. 87.
Amount $3,940.00.
Premium $196.90.

Application for Contract of Bid Bond.

Note: These should accompany this application:

1. Financial Statement, Form C413 with schedules.

2. Copy of Contract, or in case of a bid, of advertisement instructions and bid showing date
28 and signature. (Copy contract to follow.)

3. Copy of specifications, and of every contract, franchise or other document referred to in, made part of or governing the contract or bid. Plans as a rule not necessary.

Place and Date of This Application—Pensacola, Fla., Nov. 15th, 1930.

To American Surety Company of New York:
Application is hereby made for a bond of suretyship, as follows:

1. Name, age, business address and residence. (In the case of a partnership add name and residence of each partner, in the case of a corporation add names and residences of the four principal officers, and state date of organization or incorporation, name principal holders of stocks and bonds, if any.)—M. J. Gray, trading as Gray Artesian Well Company, Pensacola, Florida.

2. Name and address of obligee United States of America. (If an agent, officer or board, give full description as per contract, specifications and bond.)

3. Place and date of bid opening, if any—Washington, D. C., Nov

4. Bid Contract—For Drilling well, Pensacola, Naval Air Station, Pensacola, Fla.

5. Bid Contract—Dated .....

6. Bid Contract—Price $13,133.36.

7. Time for completion 120 days.

8. Penalty for delay—$15.00 per day.

9. Grounds for extension of time—usual conditions.

10. Terms of payment, reserved percentage—Cash.

11. Does contract cover patent indemnity? No.

12. Terms and duration of guarantees of efficiency, maintenance and repairs, if any, in contract of specifications—One Year maintenance.

13. Date of bond—Nov. 15th, 1930.

14. Amount of bond—$3940.00.

15. If a bid bond, will it operate as a contract bond? .....

16. If a bid bond, not to operate as a contract bond, amount of contract bond will be $....., if not specified, then the amount in which surety on contract bond must justify will be $.....

29

17. Limit on time for suit.....

18. Name, title and address of architect or engineer in charge—Govt. Engineer.

Note.—If the required information is not given in response to the foregoing questions, it will be necessary to return this blank for completion. The answers will be treated as strictly confidential.

19. If you bid for contract, give other bids including highest and lowest:

Name—Address.	Bid.
Layne Central Co., Memphis, Tenn.....	$13,192.00
English Constr. Co., Washington, D. C...	$13,500.00
Sprague & Henwood, Inc., Pittsburg, Pa..	$15,290.00

20. State nature of business, and if carried on in other States, territories or countries, specify the same .....

21. State number of years experience as contractor 25 years.

22. List of contracts now being performed with location, amount and percentage completed.

State Nature of Work and Owner—.....
Location—.....
Contract Price—.....
% Completed—.....
Expected completion date—.....

23. If you bid for the contract did you give a proposal bond? If so, state when, and to whom, and with what result—No.

24. Have you ever applied to any other source for a bond for this contract? If so, state when, and to whom, and with what result—No.

25. Have you furnished bonds before? Give names of your sureties. What bonds are now outstanding? Yes—American Surety Company.

26. Are you engaged or interested in any other line of business? If so, state its nature, location, firm names, names of partners, etc.—No.

27. Have you, or if a firm or corporation, has said firm or corporation, or any firm or corporation or individual to which it is a successor, or any member of said firm, ever compromised with its or his creditors, or become bankrupt or in any other way become discharged from its or his debts otherwise than by payment thereof in full? If so, state details thereof, in full, in confidential letter to be annexed .....

28. Do you carry Messenger, or Paymaster Robbery or Hold-up Insurance? If so, give particulars .. ..

29. References. Give names of your bankers, also merchants, supply houses and others who have granted you credit.

Name ..... Occupation ..... Address .....

Should the American Surety Company of New York, hereinafter called the Surety, execute or procure the execution of the suretyship hereinbefore applied for or other suretyship in lieu thereof, the undersigned, hereinafter called the Indemnitor, does, (if there be more than one Indemnitor they jointly and severally), in consideration thereof, hereby undertake and agree:

I. That the statements contained in the foregoing application are true.

II. That the Indemnitor will immediately pay the Surety at its Office, 100 Broadway, New York City $196.99 for two years ..... day of .... in each year, hereafter, until the Indemnitor shall serve upon the surety competent, written, legal evidence of its final discharge from such suretyship, and any and all renewals and extensions thereof; and in the event of said Surety executing or procuring the execution of a contract bond, or of this obligation becoming effective as a contract bond or of an award or order and no contract bond required, the Indemnitor will pay said surety ..... per cent. of the amount of the contract, award or order covered by such suretyship, annually in advance (the minimum annual premium to be that customarily charged by the Surety), until the Indemnitor shall serve upon the surety competent, written, legal evidence of its final discharge from such suretyship, and any and all renewals, and extensions thereof; and that in the event of the work to be done or material to be furnished by the contractor in the said contract being increased the Indemnitor shall pay the surety an additional premium of .... per cent. annually on such increase.

III. That the Indemnitor will perform all the conditions of said bond, and any and all renewals and extensions thereof, and will at all times indemnify and save the Surety harmless from and against every claim, demand, liability, cost, charge, counsel fee (including fees of special counsel whenever by the surety deemed necessary) expense, suit, order, judgment and adjudication whatsoever, and will place the Surety in funds to meet the same before it shall be required to make payment and in case the Indemnitor requests the Surety to join in the prosecution or defense of any legal proceeding, the Indemnitor will, on demand of the Surety, place it in funds sufficient to defray all expenses and all judgments that may be rend-

ered therein. The Indemnitor will not ask or require the Surety to remove or join in any application for the removal of any proceeding from a State Court to a Federal Court in any state where such action would in any way affect the Surety's right to transact business.

IV. That the suretyship is for the special benefit of the Indemnitor, it property, income and earnings now owned or hereafter acquired, to which the Surety looks for its Indemnity, and the indemnitor represents that it is specifically and beneficially interested therein.

V. That the surety shall have every right and remedy which a personal surety without compensation would have, including the right to secure its discharge from its suretyship, and should it make payment hereunder, shall have every right and remedy of the Indemnitor for the recovery of the same.

VI. That this agreement shall cover not only the suretyship above recited, but all alterations, renewals, extensions or modifications thereof which may be requested or assented to by the Principal named in such obligation. That the surety shall be at liberty to pay or compromise any claim or charge of the character enumerated in section III hereof, and the voucher or other evidence of the payment thereof shall be prima facie evidence of the fact and of the indemnitor's liability therefor to the surety.

VII. The Indemnitor hereby further agrees in the event of being unable to complete or carry on the contract covered by said suretyship to assign and does hereby assign to the said Surety, all right, title and interest of the Indemnitor in and to all the tools. plant, equipment and materials of every nature and description that the Indemnitor may have upon the work provided for in the contract covered by said suretyship, or

in, on or about the site thereof, including as well materials purchased for or chargeable to such contract, which may be in process of construction, on storage elsewhere, or in transportation to said site; and the Indemnitor further agrees to assign and hereby does assign to the said Surety, all the former's rights in and to all sub-contracts which may be entered into and the materials embraced therein appertaining to said contract; and the Indemnitor further agrees in the event of any breach or default on his part in any of the provisions of the contract covered by said suretyship that the said Surety, as surety, shall be subrogated to all the rights and properties of the Indemnitor in such contract, and that deferred payments and any and all moneys and securities that may be due and payable at the time of such default, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract, shall be credited for any claim that may be made upon the said Surety by reason of its suretyship as aforesaid.

32 VIII. That the Indemnitor has pledged with said Surety, as collateral security hereto and for all claims of said Surety against the Indemnitor:

and hereby agrees to keep on deposit at all times until complete performance of this agreement, and the expiration, without appeal or proceedings to review, of the time to appeal from or review, any adjudication or determination directly or indirectly fixing or discharging such liability, securities acceptable to the Surety of the value of $....., with authority to the Surety, on non-performance of any part of this agreement or any other contract between the parties hereto, without notice of amount claimed and without demand, in case said collateral is cash, to pay therefrom any sum which the indemnitor may become liable to pay the Surety

by reason of any contract between the parties hereto; in case such security is the obligation of any person, at its election to sell the same at public or private sale or to collect the same, by action or otherwise, and apply the proceeds thereof to the payment of any public or private sale or to collect the sums which may become due under any contract between the parties hereto; and in case such security consists of stocks, bonds, or other similar securities, to sell the whole or any part thereof, or any substitutes therefor, or any additions thereto, without notice at any broker's board, or at public or private sale, and to apply the proceeds thereof to the payment of any sum which may be due under any contract between the parties hereto; and upon any sale at auction or broker's board by virtue of this agreement the Surety may purchase the whole or any part of said property, discharged from any right of redemption, which is expressly released to said Surety.

IX. All the terms and conditions of this agreement shall stand for the protection of any co-surety, any reinsuring company, or any other surety procured by the American Surety Company of New York above named, whether the American Surety Company of New York does or does not execute or retain any portion of any such obligation.

Signed and sealed Pensacola, Fla. Nov. 15th, 1930.
Applicant GRAY ARTESIAN WELL CO.
Sign here By M. J. GRAY, (Seal).

Signed, sealed and delivered in presence of:
J. (name indecipherable).

Acknowledge Signatures on This Page.

State of Florida,
County of Escambia, ss.

On the 15th day of November, 1930, before me personally appeared M. J. Gray, to me known and known

to me to be the person described in and who executed the foregoing instrument, and he thereupon he acknowledged to me that he executed the same.

J. (name undecipherable)

33 (If this application is declined the Company reserves the right to withhold the reason therefor, If deemed necessary, all information relative thereto is regarded as confidential.)

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(3) OBJECTIONS OF RUNYAN-COBB BOILER WORKS TO CLAIM OF AMERICAN SURETY COMPANY.

34 (Title Omitted.)

Come now A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, creditors of the above named Bankrupt who have duly filed their claim in this proceeding and file this as their objection to the allowance of the claim filed herein by American Surety Company, and in support of, and as grounds for said objection, respectfully show unto the Court as follows, to-wit:

1.

That American Surety Company was surety on the bond given by the above named Bankrupt to the United States in connection with a contract for public work performed by the said Bankrupt for the United States under the said contract at the Naval Air Station, Pensacola, Florida. That the conditions of the said bond were those prescribed by the Statute in such cases made and provided and contained among other conditions the condition that the contractor would

promptly make payment to all persons furnishing labor and materials used in the prosecution of the work under the said contract in connection with which the said bond was given.

2.

That the penalty of the said bond was Thirty-Nine Hundred and Forty ($3940.00) Dollars. That the work on the said contract was completed but that there remained outstanding and unpaid and due and owing to people who had furnished labor and materials to the contractor, which labor and materials were used in and about the prosecution of the work under the said contract, debts amounting in the total aggregate to the sum of Fifty Six Hundred Seventy-Seven and 85/100 ($5677.85) Dollars in accounts due and payable, and all of which came within the protection of the penalty and conditions of the said bond executed by the American Surety Company as surety as aforesaid.

3.

That suit was duly brought in the United States District Court for the Northern District of Florida on the said bond and the American Surety Company appeared and paid into Court the sum of Thirty-Nine Hundred Forty ($3940.00) Dollars which was the penalty of the said bond. That after payment, under judgment of the said Court, of the costs and expenses of the said proceeding out of the penalty of the said bond there remained to be distributed pro rata to the claimants holding bills and accounts for labor and materials furnished to the contractor and used in and about the prosecution of the work under the said contract the sum of Thirty-Eight Hundred Thirty-Eight and 60/100 ($3838.60) Dollars. And that under final judgment of the United States District Court for the

Northern District of Florida this sum was distributed to the said labor and material claimants pro rata. But that the said sum was insufficient to pay up the said claims in full.

4.

That the sum of Twenty-Seven Hundred Twenty-Four and 23/100 ($2724.23) Dollars remained unpaid by the United States to the above named Bankrupt as proceeds of the contract between the Bankrupt and the United States. That the said sum was paid into the registry of the Supreme Court of the District of Columbia by the Secretary of the Navy for the United States in the case of the American Surety Company vs. M. J. Gray et als brought in said Court. That in the proceedings in the District of Columbia these objectors intervened claiming a superior right in the fund which constituted the proceeds of the contract, in the performance of which contract the labor and materials of these objectors and of other labor and material
36 claimants were used. That the Trustee in Bankruptcy of M. J. Gray also intervened in said proceeding and the result of the proceeding was that the Supreme Court of the District of Columbia ordered that the said fund, less the costs and expenses deductible therefrom be transmitted to this Court for distribution under order of this Court and in these Bankruptcy proceedings.

5.

That of the labor and material claimants holding outstanding claims of Fifty-Six Hundred Seventy-Seven and 85/100 ($5677.85) Dollars as aforesaid, all of the said claims having been adjudicated by the United States District Court for the Northern District of Florida, the following have filed their claim in

these Bankruptcy proceedings, viz: these objectors: Runyan Machine and Boiler Works; Standard Sanitary Manufacturing Company; H. L. Gray; W. C. Gray, Ray Hardware and Truck Company; National Cast Iron Pipe Company; Frederick Gilmore and Company; and Electric Controller Manufacturing Company. That the claim of these objectors was adjudicated to be Twenty-Nine Hundred Fifty-One and 94/100 ($2,951.94) Dollars for labor and materials furnished the contractor on the contract aforesaid, without interest; and that of Runyan Machine and Boiler Works was adjudicated to be in the sum of Forty-Nine and 74/100 ($49.74) Dollars; that of T. D. Brux Company to be in the sum of One Hundred Eleven and 65/100 ($111.65) Dollars; that of Standard Sanitary Manufacturing Company to be in the sum of One Hundred Ten and 14/100 ($110.14) Dollars; that of H. L. Gray to be in the sum of Two Hundred ($200.00) Dollars; that of W. C. Gray to be in the sum of Three Hundred Fifty-Two ($352.00) Dollars; that of Ray Hardware & Truck Company to be in the sum of Eighty-Five and 02/100 ($85.02) Dollars; that of National Cast Iron Pipe Company to be in the sum of Four Hundred Thirty-Five and 51/100 ($435.51) Dollars; that of Frederick Gilmore and Company to be in the sum of Fifty-Seven and 47/100 ($57.47) Dollars; and that of Electric Controller Manufacturing Company to be in the sum of Four Hundred Eight and 60/100 ($480.60) Dollars. That the payments on account of these claims, as distributed by judgment of the United States District Court for the Northern District of Florida were as follows, viz: to these objectors Eighteen Hundred Thirty-Five and 55/100 ($1835.55) Dollars; to Runyan Machine and Boiler Works Thirty and 87/100 ($30.87) Dollars; to T. D. Brux Company Sixty-Nine and 33/100 ($69.33) Dollars; to Standard Sanitary Manufacturing Company Sixty-Eight and 39/100 ($68.39) Dollars; to H. L. Gray, One Hundred Twenty-four

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and 19/100 ($124.19) Dollars; to W. C. Gray Two Hundred Eighteen and 57/100 ($218.57) Dollars; to Ray Hardware and Truck Company Fifty-Two and 79/100 ($52.79) Dollars; to National Cast Iron & Pipe Company Two Hundred Seventy and 43/100 ($270.43) Dollars; to Frederick Gilmore and Company Thirty-Five and 69/100 ($35.69) Dollars; and to Electric Controller Manufacturing Company Two Hundred Ninety-Eight and 43/100 ($298.43) Dollars. That the difference between the adjudicated amounts of these claimants and the amounts received as the proceeds of the distribution of the penalty of the bond, plus interest from August 1st, 1931 are still due and payable to the claimants aforesaid for account of labor and materials furnished to the contractor, M. J. Gray and used in the prosecution of the work performed under said contract which labor and materials created the fund of Twenty Seven Hundred Twenty-Four and 23/100 (2724.23) Dollars.

6.

That the American Surety Company has not paid any of the sums mentioned in paragraph twelve of its claim except that it caused to be paid The Standard Sanitary Manufacturing Company the sum of One Hundred Ten and 14/100 ($110.14) Dollars. That the Standard Sanitary Manufacturing Company has filed its claim in these proceedings for the said One Hundred Ten and 14/100 ($110.14) Dollars. That the said claim in truth and in fact, so these objectors are informed and believe and therefore aver, belong to American Surety Company but the said claims was assigned to Knowles Brothers Agency as assignee and this assignee appeared in the proceedings in the United States District Court for the Northern District of Florida in which the proceeds of the penalty of the bond aforesaid were distributed

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and Knowles Brothers Agency collected on account of the said claim the sum of Sixty-eight and 39/100 ($68.39) Dollars. That to the extent of the Standard Sanitary Manufacturing Company's claim less the payment made to Knowles Brothers Agency as assignee, plus interest from the date of payment by American Surety Company to Standard Sanitary Manufacturing Company, the American Surety Company is entitled to participate in the proceeds of the Twenty-Seven Hundred Twenty-Four and 23/100 ($2724.23) Dollars fund. But Standard Sanitary Manufacturing Company's claim is in and American Surety Company's claim is a duplicate of the claim of the original creditor. That none of the other claims mentioned in said paragraph twelve has been paid by American Surety Company.

7.

That the labor and material claimants aforesaid have filed claims in these proceedings and are entitled to have balances due them paid in full with interest out of the fund of Twenty-Seven Hundred Twenty-Four and 23/100 ($2724.23) Dollars, less the necessary costs and expenses to be allowed by this Court out of the said fund. And that the American Surety Company has no right to the fund, or to any part thereof, until and unless the said material and labor claimants who under the law have a special equity in the said fund, shall have paid in full for the material and labor claims they have against the above named Bankrupt arising and accruing by reason of labor and materials furnished the said Bankrupt and used by him in and about the prosecution of the work under the contract aforesaid.

Wherefore, these objectors object to the said claim of American Surety Company and assert their right to a superior equity in the said fund, together with the

pro rata right of the other labor and material claimants who have filed their claims in this Bankruptcy proceeding.

WM. FISHER,
Attorney for Objectors.

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(4) SUPPLEMENTAL PROOF OF CLAIM OF AMERICAN SURETY COMPANY.

39 (Title Omitted.)

State of New York,
County of New York.

1.

At the Borough of Manhattan in the City, County and State of New York, on the 6th day of September, 1933, came Chas. W. Goetchius of the Borough of Brooklyn, City of New York and State of New York, and made oath and says that he is the Treasurer of the American Surety Company of New York, a corporation organized and existing under and by virtue of the laws of the State of New York, and having its office and principal place of business at No. 100 Broadway, Borough of Manhattan, City, County and State of New York, and that he is duly authorized to make this proof.

2.

That he has heretofore on the 18th day of January 1932, made proof of the claim of said American Surety Company of New York against the estate in Bankruptcy of M. J. Gray, trading as Gray Artesian Well Company, and filed said proof in this Court on January

20, 1932, before the Referee in Bankruptcy herein, and now makes this supplemental proof of the claim then made and filed by him.

3.

That said American Surety Company of New York has not been required to make any payment by reason of the execution by it as surety of the bond of said M. J. Gray, trading as aforesaid, for $500.00 to the American National Bank of Pensacola, Florida, mentioned and described in paragraph 4 of said original proof of claim, nor on account of the execution by it as surety of the bond of said M. G. Gray, trading as aforesaid, for $2475.00 to the City of Bainbridge, Georgia, mentioned and described in paragraph 5 of said original proof of claim.

4.

That paragraph 9 of said original proof of claim shows the execution by said American Surety Company of New York as surety, of the bond of said M. J. Gray, trading as aforesaid, in the amount of $3940.00 to United States of America, securing the performance of a contract of said M. J. Gray, trading as aforesaid, for drilling well at Naval Air Station, Pensacola, Florida; and other paragraphs of said proof of claim show the presentation to said American Surety Company of New York as surety upon said bond, of claims by various persons of amounts asserted to be due them for labor and materials furnished to said M. J. Gray, trading as aforesaid in the performance of said contract.

5.

That after the filing of said original proof of claim a proceeding was instituted in the District Court of the United States for the Northern District of Florida,

in accordance with the statutes of the United States, by the United States of America for the use and benefit of A. G. Runayn, Randall Bell and Sheppard Cobb, co-partners trading under the firm name of Runyan-Cobb Boiler Works, as plaintiffs, against M. J. Gray, trading as Gray Artesian Well Company, and American Surety Company of New York, as defendants, seeking the recovery of $2951.94 from the defendant M. J. Gray, trading as aforesaid, and from the said defendant American Surety Company of New York, as surety upon the bond for $3940.00 mentioned in paragraph 4 hereof on account of labor and materials furnished to said M. J. Gray, trading as aforesaid, for use in the prosecution of the work under his said contract with the United States of America; and thereafter various other persons intervened in said proceedings and sought to recover against the defendants therein amounts likewise claimed to be due them for labor and materials furnished to said M. J. Gray,
41 trading as aforesaid for use in the prosecution of the work provided for in said contract; and said American Surety Company of New York filed its answer in said proceeding admitting the execution of said bond and thereafter in pursuance of an order entered by the said Court in the said proceeding on the 8th day of September, 1932, said American Surety Company of New York deposited with the Clerk of the said Court in pursuance of the statutes of the United States the sum of $3940.00, being the amount of the penalty of the bond sued upon therein, and thereafter by another order entered by said Court in said proceeding on the 21st day of September, 1932, said American Surety Company of New York was discharged from further liability and obligation upon said bond; and thereafter by another order entered in said cause on the 15th day of November, 1932, the said fund so deposited with the Clerk of said Court was disbursed and distributed to the plaintiffs and the several interveners

therein on account of their said claims for materials and supplies furnished to said M. J. Gray, trading as aforesaid; that the aggregate amount of the said claims for labor and materials as determined by the Court was largely in excess of the penalty of said bond and by said order the amount so deposited as the penalty of said bond was distributed pro rata among said claimants to be applied upon the amounts of their claims as adjudicated, leaving balances due thereon; that by the terms of said order after allowing the amount of $39.40 for costs of the Clerk of said Court and an aggregate of $62.00 for costs of plaintiffs and interveners therein the remainder, to-wit: the sum of $3838.60 was apportioned and distributed and was thereafter by the clerk of said Court paid to said claimants in
42 the amounts set opposite their respective names as follows:

Runayn-Cobb Boiler Works,	$1835.56
Runyan Machine & Boiler Works,	30.87
T. D. Brux Company,	69.33
Ferriss Lee Lumber Company,	81.00
C. S. Woodward Electric Company,	127.70
Knowles Bros. Agency,	68.39
Wright Oil Company,	45.53
H. L. Gray,	124.19
L. M. Gray,	61.47
W. C. Gray,	218.57
Ray Hardware & Truck Co.,	52.79
Roquemore Gravel Company,	37.64
Electric Controller Mfg. Co.,	298.43
National Cast Iron Pipe Company,	270.43
Walter A. Taylor,	248.38
Frederick Gilmore & Company,	35.69
Westinghouse Electric & Mfg. Co.,	232.63

6.

That said American Surety Company of New York has been required to expend and has expended in con-

nection with its said bond for $3940.00 mentioned in paragraph 4 hereof certain amounts for investigation of claims against it arising and asserted on account of said bond and for the defense of the suit brought against it upon said bond in the United States District Court for the Northern District of Florida and mentioned in paragraph 5 hereof, and in the litigation instituted by it in the Supreme Court of the District of Columbia, mentioned in paragraph 7 hereof, to establish the priority of its claim against the amount hereinafter mentioned remaining due by the United States of America to said M. J. Gray, trading as aforesaid, which expenses aggregate the sum of $521.81 and for which said American Surety Company of New York has not been reimbursed.

7.

That upon the acceptance by the United States of America of the work of said M. J. Gray,
43 trading as aforesaid, under his said contract with the United States for the drilling of said well at Naval Air Station, Pensacola, Florida, there remained due to him from the United States $2724.07 of the amount to be paid him under said contract, but large amount were due by him for labor and materials furnished in said work; that the said amount remaining due under said contract was pdi into the Supreme Court of the District of Columbia in a proceeding brought therein by American Surety Company of New York, against W. H. Owens, Trustee in Bankruptcy of M. J. Gray Artesian Well Company, Charles F. Adams. Secretary of the Navy and others, to enforce a lien and priority upon the amount so remaining due by the United States, but the Supreme Court of the District of Columbia declimed to adjudicate the priorities of the several claims to said fund made in said proceed-

ing and ordered the said fund paid to the Trustee in Bankruptcy of said M. J. Gray, trading as aforesaid, and the said fund was thereafter paid to said Trustee in Bankruptcy for distribution in the administration of the estate of said bankrupt as this Court should determine.

8.

That by reason of the facts alleged in said original proof of claim and in this supplemental proof, said American Surety Company of New York was, and is, entitled to a lien upon the said amount remaining due by the United States upon its said contract with M. J. Gray, trading as aforesaid, which has now been paid as aforesaid to the Trustee in Bankrupty of said M. J. Gray, and is now held by said Trustee, to secure to it repayment of the amount of the penalty of its said bond in the amount of $3940.00 paid as aforesaid to the furnishers of materials and supplies to the said M. J. Gray, trading as aforesaid, and the said sum of $521.81 paid out by it as expenses in connection with said bond and its liability thereon, in preference to and with priority over the claims of other creditors of said bankrupt, including creditors with claims for materials and supplies furnished in performance of the said contract with the United States of America.

CHAS. W. GOETCHIUS,
Treasurer of American Surety Co., of New York.

Sworn and Subscribed to before me this 6th day of September, A. D. 1933.

(Seal)

J. P. BREARTON,
Notary Public.

(5) ADDITIONAL OBJECTIONS OF RUNYAN-COBB BOILER WORKS TO SUPPLEMENTAL PROOF OF CLAIM OF AMERICAN SURETY COMPANY.

44 (Title Omitted.)

Now comes Runyan-Cobb Boiler Works and adopts as its objections to the supplemental proof of claim filed by American Surety Company September 15, 1933, the allegations of the objections to the original claim filed by American Surety Company.

WM. FISHER,
Attorney for Runyan-Cobb Boiler Works.

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(6) OBJECTIONS OF WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY AND OTHERS TO SUPPLEMENTAL PROOF OF CLAIM OF AMERICAN SURETY COMPANY.

(Title Omitted.)

Now come Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, and Frederick Gilmore & Company, whose claims and interventions have been duly filed in this cause, and file this their objections to the allowance of the claim of the American Surety Company, a corporation, herein, and for grounds of said objections show unto the Court as follows, to-wit:

45 1.

That these creditors furnished to the bankrupt labor and/or materials for use in, and which were necessary

to be used in, and which were actually used in the performance by the bankrupt of its contract with the United States of America mentioned in the petition of said American Surety Company; that there has been paid to them the amounts respectively set opposite their names in paragraph 5 of the amendment to the claim of said American Surety Company, leaving a balance due them respectively on their said claims as set forth in their claims and petitions filed herein, reference to which being hereby made; that the sums heretofore received by them on their said claims represented their pro rata part of the $3940.00 paid into the Registry of the District Court of the United States for the Northern District of Florida by said American Surety Company as set forth in their claims filed herein; that said sum was wholly insufficient to pay and discharge all of the claims of these creditors, as well as the claims of other creditors who furnished labor, materials and supplies which were used by the said bankrupt in the performance of his contract with the United States of America as aforesaid; that the sum of $2724.07 mentioned in said claim of American Surety Company represents the balance due from the United States of America to said bankrupt under the contract mentioned in the claim of said company, and represents the proceeds of said contract.

2.

That there is now due and owing to your several petitioners the amounts set forth in their respective claims and petitions filed herein, with interest, as aforesaid, and that said balance due them is for work and materials and/or labor furnished to and used by said bankrupt in the performance of his contract with the United States of America mentioned in the claims of said American Surety Company, and to guarantee the performance of which contract and the payment of all

claims for labor and materials the said American Surety Company executed the bond mentioned in its claim; that no part of said balance due these creditors has been paid by said American Surety Company, or any person whomsoever.

46

3.

That the said sum of $2724.07, or so much thereof as has come to the hands of the Trustee in Bankruptcy in this cause, less such costs and expenses as the Court shall order to be paid therefrom, is and represents a trust fund, charged with a special equity or equitable lien in favor of these creditors and in favor of other creditors of said bankrupt who likewise furnished labor, materials and supplies which were necessary to enable said bankrupt to perform his contract aforesaid, and which were used by said bankrupt in the performance of said contract; and these creditors show unto the Court that their equity to have said fund, or so much thereof as may be necessary to satisfy and discharge their said claims, paid over to them for such purpose, is superior to any right or equity in or to said fund of the said American Surety Company, a corporation, which said company did not furnish any labor, materials or supplies to enable the said bankrupt to perform his contract aforesaid, but which guaranteed the performance of said contract by said bankrupt and guaranteed by its bond the payment of all claims for labor and materials used in the performance of said contract, up to the amount of the penalty of its bond aforesaid; and these creditors allege that in equity and in justice they were and are entitled to look to the full amount of the penalty of said bond plus the amount of the balance due on said contract and which has come to the hands of the Trustee aforesaid, or so much thereof as may be necessary, to satisfy and discharge their said claim before the said American Surety Com-

pany should be entitled to enforce any claims against said fund now in the hands of the Trustee in Bankruptcy as alleged in their said petition, merely by reason of their having executed as surety the bond of said bankrupt, and merely by reason of the other facts alleged in their said petition.

47 Wherefore, these creditors object to the said claim of said American Surety Company, a corporation, insofar as it seeks to share on a priority of, and/or on an equality with their rights in said fund now in the custody of this Court, and allege that they have or are entitled to assert a superior right and equity in said fund, together with the pro rata right of the other labor and material claims entitled to share in said fund, superior to any right or claim thereto or therein of said American Surety Company, a corporation.

WATSON & PASCO & BROWN,
Attorneys for Objectors.

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(7) ORDER OF THE REFEREE DATED NOVEMBER 21, 1933, SUSTAINING THE OBJECTIONS TO THE CLAIM OF PRIORITY OF AMERICAN SURETY COMPANY.

(Title Omitted.)

This cause coming on to be heard upon the objections of Westinghouse Electric Mfg. Company, National Cast Iron Pipe Company, Walter A. Taylor, Frederick Gilmore & Company, and Runayn-Cobb Boiler Works, creditors of this estate in bankru tcy to the allowance of the petition of the American Surety Company, for priority of payment of its claim and the same

having been duly considered by the Court after argument by counsel for the respective parties, and the Court being advised of its opinion in the premises, it is:

Ordered, Adjudged and Decreed that the said objections be and the same are hereby sustained and that the said petition of the American Surety Company for priority be and the same is hereby denied.

48 It Is Further Ordered that W. H. Owens, trustee, be and he is hereby authorized and directed to distribute all money now in his hands ratably among all creditors of this estate which have heretofore allowed priority and, when said priority claimants are paid in full, to pay the balance of said money, if any there be, to the American Surety Company on account of its aforesaid claim.

Done And Ordered at Pensacola in said District this 21st day of November, A. D. 1933.

ALSTON FISHER,
Referee in Bankruptcy.

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(8) PETITION OF AMERICAN SURETY COMPANY FOR REVIEW BY THE DISTRICT JUDGE OF THE REFEREE'S ORDER DATED NOVEMBER 21, 1933.

(Title Omitted.)

To the Honorable Alston Fisher, Referee in Bankrupt:

The petition of American Surety Company, a corporation respectfully represents that it is a creditor of the above named bankrupt and that its claim against the estate of said bankrupt and its amendment of said claim have heretofore been filed in this proceeding

and that heretofore an order has been entered in this cause by Your Honor as such Referee dated the 21st day of November, A. D. 1933, a copy of which is hereby annexed; that such order was erroneous in that:

1. It sustained the objections of Westinghouse Electric Mfg. Company; National Case Iron Pipe Company; Walter A. Taylor; Frederick Gilmore & Company and Runyan-Cobb Boiler Works, creditors of said estate in bankruptcy, to the allowance of petitioner's claim for priority of payment as set forth in its amended claim.

49 2. It denied your petitioner priority of payment of its claim from the fund in the hands of the Trustee arising as retained payment out of the construction contract between the bankrupt and the United States of America, as alleged in petitioner's amended claim.

3. It directed the Trustee herein to distribute said fund ratably among all creditors heretofore allowed priority in disregard of the right of petitioner to priority of the payment out of and a lien upon the fund aforesaid.

Wherefore, Your petitioner prays that the said order of November 21st, A. D. 1933, may be reviewed by the Judge of this Court as provided by the Statutes of the United States and by General Order No. XXVII in Bankruptcy, and that Your Honor as such Referee shall certify the same to the Judge as in said General Order provided.

This 14th day of December, A. D. 1933.

CARTER & YONGE,
Attorneys for Petitioner.

(9) ORDER OF DISTRICT JUDGE DATED MARCH 8TH, 1934, SUSTAINING THE REFEREE'S ORDER DATED NOV. 21, 1933.

50 In the District Court of the United States for the Northern District of Florida.

In the Matter of:

Melton J. Gray, trading as Gray Artesian Well Company, Bankrupt.

Claim of American Surety Company of New York, a Corporation.

This cause coming on to be heard upon the petition of American Surety Company of New York, a corporation, for a review by this Court of the order made by Hon. Alston Fisher, a Referee in Bankruptcy of this Court, on the 21st day of November, A. D. 1933, sustaining the objections of Westinghouse Electric Manufacturing Company, National Cast Iron Pipe Company, Walter A. Taylor, Frederick Gillmore & Company and Runyan-Cobb Boiler Works, creditors of said estate in bankruptcy, to priority of payment of the claim of said American Surety Company of New York, from certain funds of the said estate in bankruptcy; and upon the certificate of the said Referee in Bankruptcy dated the 14th day of December, A. D. 1933 filed herein in pursuance of said petition; and upon the contract of said Gray Artesian Well Company with the United States of America and the bond of said Gray Artesian Well Company as principal and said American Surety Company of New York as surety, given to the United States of America in connection with said contract, and the application of said Gray Artesian Well Company to said American Surety Company for

said bond and its contract of indemnity with said American Surety Company, all of which are filed with and a part of said certificate; and also upon the original and supplemental proof of claim of said American Surety Company of New York and the objections thereto of Runyan-Cobb Boiler Works, Westinghouse Electrict Manufacturing Company, National Cast Iron Pipe Company, Walter A. Taylor and Frederick Gillmore Company, filed with and a part
51 of the said certificate of said Referee, and this Court having considered the same and having heard the arguments of counsel for said American Surety Company and said creditors objecting to its claim and being advised of its opinion that the said order of the said Referee should be sustained;

It Is Therefore Considered, Ordered And Adjudged that the said order of the said Referee dated November 21, A. D. 1933 be, and the same is hereby approved and sustained.

Done And Ordered at Chambers at Pensacola in the said Northern District of Florida, on this the 8th day of March, A. D. 1934.

WM. B. SHEPPARD,
Judge.

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(10) PETITION OF AMERICAN SURETY COMPANY FOR ALLOWANCE OF APPEAL TO THE CIRCUIT COURT OF APPEALS.

52 (Title Omitted.)

Now comes American Surety Company of New York, a corporation, in the above stated cause and feeling

itself aggrieved by the order and final judgment entered therein against it dated March 8th, 1934, sustaining the order of Hon. Alston Fisher, a Referee in Bankruptcy of said Court, dated November 21st, 1933, which order sustained the objections of certain creditors of said estate in Bankruptcy namely: Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Company, a corporation, and A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runayn-Cobb Boiler Works to the claim of said American Surety Company of New York to priority of payment from certain funds of said estate in Bankruptcy, does hereby enter its appeal from said final judgment dated March 8th, 1934, to the United States Circuit Court of Appeals for the Fifth Circuit, for the reasons set forth in the assignment of errors hereunder written and presented herewith; and in connection with said appeal respondent herewith presents security by bond for supersedeas in the sum of $250.00 conditioned that it shall prosecute its appeal
53 to effect and if it fails to make its plea good, shall answer all damages and costs; and it prays that said appeal be allowed; that said security by bond be approved as to the surety thereon and the amount, form, execution and sufficiency thereof; that said appeal do operate as a supersedeas and that a transcript of the record of the proceedings in said cause be duly authenticated and sent to said Appellate Court in accordance with the law and the rules in said cases made and provided.

CARTER & YONGE,
Attorneys for American Surety Company of New York.

(11) ASSIGNMENT OF ERRORS ON APPEAL OF AMERICAN SURETY COMPANY.

(Title Omitted.)

Now comes said American Surety Company of New York and in connection with the foregoing appeal entered from the final judgment against it and in favor of said objecting creditors, dated March 8th, 1934, in the cause mentioned in said appeal, files this its assignment of errors and says that in the record, proceeding and judgment aforesaid manifest error hath happened and intervened to its prejudice and it assigns the following errors on its said appeal, to-wit:

54 The District Court in and by its order and final judgment dated March 8th, 1934, erred in:

1. Approving and sustaining the order of Alston Fisher, Referee in Bankruptcy, dated November 21, 1933.

2. Approving and sustaining the order of Alston Fisher Referee in Bankruptcy dated November 21, 1933, which sustained the objections of certain objecting creditors; namely, Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Company, a corporation, and A. G. Runayn, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, to the claim of said American Surety Company of New York to priority of payment from certain funds of the estate of Melton J. Gray. trading as Gray Artesian Well Company in bankruptcy.

3. Denying to said American Surety Company of New York, priority of payment of its claim against

said estate in bankruptcy from the fund in the hands of the Trustee in Bankruptcy of said estate arising as retained payment out of the construction contract between said bankrupt and the United States of America.

4. Directing the said Trustee in Bankruptcy to distribute the fund in his hands arising as retained payment out of the construction contract between said bankrupt and the United States of America ratably among all of the creditors of said estate theretofore allowed priority, in disregard of the right of said American Surety Company of New York to priority of payment out of and a lien upon the said fund.

5. Holding that American Surety Company of New York, as surety upon the said bankrupt's performance bond given to secure its construction contract with the United States of America, is not entitled to a lien upon, or priority of payment out of, the fund remaining in the hands of the United States (and now held by the trustee as a part of the bankrupt's estate) upon completion of the bankrupt's construction contract and constituting the retained payments under the balance due to the bankrupt upon his construction contract.

6. Holding that the American Surety Company of New York, as surety upon the said bankrupt's performance bond given to secure its construction contract with the United States of America, is not entitled under the bond and its contract of indemnity with its principal to priority of payment of its claim for reimbursement of the amounts it was required to pay under the bond to creditors who furnished materials used by the bankrupt in the performance of his contract, out of the retained payments under the contract remaining in the hands of the United States of America upon the

completion of the contract and now held by the trustee in bankruptcy of the contractor as a part of the bankrupt's estate.

CARTER & YONGE,
Attorneys for American Surety Company of New York.

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(12) ORDER OF THE DISTRICT JUDGE DATED APRIL 7TH, 1934, ALLOWING APPEAL.

(Title Omitted.)

On the 7th day of April, 1934, said American Surety Company of New York named in the foregoing appeal and assignment of errors, presented and filed
56 the same together with security by bond for supersedeas in the sum of $250.00 with this Court, and the Court having duly considered the same and being advised of its opinion;

It Is Therefore Considered And Ordered that the said appeal as prayed for and entered be and the same is hereby allowed, returnable May 5th, 1934, for review by the United States Circuit Court of Appeals for the Fifth Circuit of the final judgment dated March 8th, 1934, and the proceedings in said cause as mentioned and set out in said appeal and assignment of errors; that the security by bond for supersedeas presented therewith and described therein be and the said is hereby approved as to the surety thereon and as to the amount, form, execution and sufficiency thereof; that said appeal do and shall operate as a supersedeas and that citation on said appeal do issue to Westinghouse Electric Manufacturing Company, a corporation,

National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Company, corporation, A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, W. H. Owens, as Trustee of the said estate of Melton J. Gray, Trading as Gray Artesian Well Company in bankruptcy, Runyan Machine & Boiler Works, a corporation, Knowles Bros. Agency, a corporation, H. L. Gray, W. C. Gray, Ray Hardware & Truck Company, a corporation, Electric Controller and Manufacturing Company, a corporation, T. D. Brux Company, a corporation, returnable May 5th, 1934.

Done And Ordered at Pensacola in the Northern District of Florida, on this 7th day of April, 1934.

WM. B. SHEPPARD,
District Judge.

Receipt is hereby acknowledged of copies of the above appeal, assignment of errors, order made thereon and supersedeas bond referred to therein this 4th day of April, 1934.

WATSON & PASCO & BROWN,
Attorneys for Westinghouse Electric Manufacturing Company, National Cast Iron Pipe Company, Walter A. Taylor and Frederick Gillmore & Company.

57 FISHER & FISHER,
Attorneys for A. G. Runayn, Randall Bell and Sheppard Cobb, trading as Runayn-Cobb Boiler Works, T. D. Trux Company, a corporation, and Runyan Machine and Boiler Works.

J. McHENRY JONES,
Attorney for W. H. Owens, Trustee in Bankruptcy of the estate of Melton J. Gray, trading in Gray Artesian Well Company.
HOLSBERRY & HOLSBERRY,
Attorneys for H. L. Gray, W. C. Gray, Ray Hardware and Truck Company and Electric Controller and Manufacturing Company,
KNOWLES BROS. AGENCY,
By KNOWLES HYER,
Vice-Pres. & Gen. Mgr.

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(13) BOND OF AMERICAN SURETY COMPANY ON APPEAL.

Know All Men By These Presents: That we, American Surety Company of New York, a corporation, and Hartford Accident and Indemnity Company, a corporation duly authorized to do a surety business in the State of Florida and to become surety upon bonds authorized or required to be given in proceedings in the Federal Courts having jurisdiction in the Northern District of Florida, are held and firmly bound unto Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Co., a corporation, A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, W. H. Owens, as Trustee of the estate of Melton J. Gray, Trading as Gray Artesian Sell Company in bankruptcy, Runyan Machine Boiler

Works a corporation, Knowles Bros. Agency, a corporation, H. L. Gray, W. C. Gray, Ray Hardware & Truck Company, a corporation, Electric Controller and Manufacturing Company, a corporation and T. D. Brux Company, a corporation, jointly and severally in the sum of Two hundred and Fifty ($250.00) Dollars for the payment whereof well and truly to be made, we bind ourselves and our successors jointly and severally firmly by these presents.

58 Signed And Sealed this 2nd day of April, 1934.

The condition of the foregoing obligation is such that, whereas lately in the District Court of the United States for the Northern District of Florida, in the matter of Melton J. Gray, trading as Gray Artesian Well Company bankrupt, in bankruptcy, upon the objections of Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Company, a corporation, and A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works to the claim of said American Surety Company of New York, a corporation, a final judgment was rendered dated the 8th day of March, 1934 against said American Surety Company of New York, sustaining the objections of said objecting creditors to the claim of said American Surety Company of New York, to priority of payment from certain funds of said estate in bankruptcy; and said American Surety Company of New York has taken and entered its appeal from said judgment to the United States Circuit Court of Appeals for the Fifth Circuit to review said judgment and the proceedings in said cause, which appeal has been allowed;

Now Therefore, if the said American Surety Company of New York, a corporation, shall prosecute its said appeal to effect and, if it fails to make good its plea, shall answer all damages and costs, then this obligation shall be null and void, otherwise to be and remain in full force and effect.

AMERICAN SURETY COMPANY OF NEW YORK,
By CHAS. W. GOETCHIUS,
(Corporate Seal) Vice President.

Attest:
(Name indecipherable),
Assistant Secretary.

HARTFORD ACCIDENT & INDEMNITY COMPANY OF HARTFORD, CONN.,
By (Name indecipherable),
Attorney-n-Fact.

The foregoing bond is approved both as to surety thereon and as to its amount, sufficiency and form as security for supersedeas this 7th day of April, 1934.

WM. B. SHEPPARD,
U. S. District Judge.

59 State, City and County of New York, ss:

On this 2nd day of April, 1934, before me personally appeared Chas. W. Goetchius, Vice-President of the American Surety Company of New York, to me known, who being by me duly sworn, did depose and say that he resides in the City of New York; that he is the Vice-President of the American Surety Company of New York, the Corporation described and which executed the above instrument; that he knows the corporate seal of said Corporation; that the seal affixed to said instrument is such corporate

seal; that it was so affixed by order of the Board of Trustees of said corporation, and that he signed his name thereto by like order; and that the liabilities of said Corporation do not exceed its assets as ascertained in the manner provided by law. And the said Chas. W. Goetchius further said that he is acquainted with Vincent W. Nash and knows him to be the assistant secretary of said Corporation, that the signature of said Vincent W. Nash subscribed to the said instrument, is in the genuine handwriting of the said Vincent W. Nash and was thereto subscribed by the like order of the said Board of Trustees, and in the presence of him the said Chas. W. Goetchius, Vice-President.

J. P. BREARTON,
Notary Public, New York
(Seal) County No. 227, etc.

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(14) CITATION ON APPEAL.

United States of America: ss.

The President of the United States to Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gilmore & Company, a corporation, A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, W. H. Owens, as Trustee of the said estate of Melton J. Gray, trading as Gray Artesian Well Company, in bankruptcy, Runyan Machine and Boiler Works, a corporation, Knowles Bros.
60 Agency, a corporation, H. L. Gray, W. C. Gray, Ray Hardware & Truck Company, a corporation, Electric Controller and Manufacturing Company, a corporation, and T. D. Brux Company, a corporation, Greeting:

You are hereby cited and admonished to be and appear at a term of the United States Circuit Court of Appeals for the Fifth Circuit to be held at the City of New Orleans in the State of Louisiana on the 5th day of May, 1934, pursuant to an order allowing an appeal duly entered of record in the Clerk's office of the District Court of the United States for the Northern District of Florida wherein American Surety Company of New York, a corporation, is appellant and Westinghouse Electric Manufacturing Company, a corporation, National Cast Iron Pipe Company, a corporation, Walter A. Taylor, Frederick Gillmore & Company, a corporation, A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, W. H. Owens, as Trustee of the estate of Melton J. Gray, trading as Gray Artesian Well Company, in bankruptcy, Runyan Machine and Boiler Works, a corporation, Knowles Bros. Agency, a corporation, H. L. Gray, W. C. Gray, Ray Hardware and Truck Company, a corporation, Electric Controller and Manufacturing Company, a corporation and T. D. Brux Company, a corporation, are appellees, to show cause, if any there be, why the final judgment rendered against said appellant and in favor of appellees dated March 8th, 1934, as mentioned in said appeal and order allowing same should not be corrected and why speedy justice should not be done to the parties in that behalf.

Witness the Honorable W. B. Sheppard, Judge of the United States District Court for the Northern District of Florida, at Pensacola, in said District, this 7th day of April, 1934.

WM. B. SHEPPARD,
U. S. District Judge.

Due, timely and sufficient service of the foregoing citation on appeal is hereby acknowledged this 7th day of April, 1934.

WATSON & PASCO & BROWN,

61 Attorneys for Westinghouse Electric Manufacturing Co., Nat'l Cast Iron Pipe Company, Watler A. Taylor and Frederick Gillmore and Company.

FISHER & FISHER,

Per WM. FISHER,

Attorneys for A. G. Runyan, Randall Bell and Sheppard Cobb, trading as Runyan-Cobb Boiler Works, T. D. Brux Company, a corporation, and Runyan Machine and Boiler Works.

J. McHENRY JONES,

Attorney for W. H. Owens, Trustee in Bankruptcy of the Estate of Melton J. Gray, trading as Gray Artesian Well Company.

HOLSBERRY & HOLSBERRY,

Attorneys for H. L. Gray, W. C. Gray, Ray Hardware and Truck Company, and Electric Controller and Manufacturing Company.

KNOWLES BROS. AGENCY,

By KNOWLES HYER.

62 United States District Court, Northern District of Florida.

I, F. W. MARSH, Clerk of the United States District Court, in and for the Northern District of Florida, do hereby certify that the foregoing pages numbered one to 61 contain a true and correct transcript of the proceedings in the matter of Melton J. Gray, trading as Gray Artesian Well Company, Bankrupt: Objections to claim of American Surety Company of New York; as set forth in the Directions to Clerk for preparation of said transcript, and taken from the original papers on file in this office.

Witness my hand and the seal of this Court at Pensacola, Florida, this 19th day of April, A. D. 1934.

F. W. MARSH, Clerk,
By MARION HOWE,
Chief Deputy Clerk.

(Seal)

[fol. 80] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

No. 7382

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation,

versus

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a Corporation, et al.

ARGUMENT AND SUBMISSION

Extract from the Minutes of January 28th, 1935

On this day this cause was called, and, after argument by J. E. D. Yonge, Esq., for appellant, and Wm. Fisher, Esq., for appellees, was submitted to the Court.

[fol. 81] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 7382

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation, Appellant,

versus

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a Corporation, et al., Appellees

Appeal from the District Court of the United States for the Northern District of Florida

(February 13, 1935)

Before Bryan, Sibley and Walker, Circuit Judges

OPINION OF THE COURT AND DISSENTING OPINION OF SIBLEY, CIRCUIT JUDGE—Filed February 13, 1935

WALKER, Circuit Judge:

The appellant was the surety on a bond in the sum of $3,940.00, given in pursuance of statute (40 U. S. C. A.

§270) to secure performance by one Gray of his contract with the United States for drilling a well at the Pensacola Naval Air Station, which contract included the provision that the contractor would promptly make payment to all persons supplying the contractor with labor and materials [fol. 82] in the prosecution of the work provided for in the contract. Gray completed the work contracted for, but remained indebted, in the sum of $5,677.85, to appellees, who had supplied materials used in the work contracted for; and Gray was adjudged bankrupt. Appellant appeared in a suit instituted in the court below on the bond, and paid into court the amount of the penalty of the bond, $3,940.00, which amount was distributed ratably to the appellees, leaving substantial balances still owing by the contractor to the appellees. After the completion of the work called for by the contract, the United States owed the contractor $2,774.23, being the amount of ten per cent of estimates, retained pursuant to a provision of the contract. That sum was paid to the trustee of the estate of the bankrupt contractor. In the bankruptcy proceeding the appellees claimed that they were entitled to a lien on that fund and to priority of payment therefrom of the balance remaining due to them; and the appellant asserted the claim that it had a lien on or a prior right to that sum for the repayment to it of the amount of the penalty of the bond which had been paid. The proof of claim filed by the appellant made an exhibit thereto a copy of a contract of indemnity executed to the appellant by the contractor prior to the time of appellant becoming surety on the bond, which indemnity contract contained the provision: "and the Indemnitor further agrees in the event of any breach or default on his part in any of the provisions of the contract covered by said suretyship that the said Surety, as Surety, shall be subrogated to all the rights and properties of the Indemnitor in such contract, and that deferred payments and any and all moneys and securities that may be due and payable at the time of such default, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract, shall be credited for [fol. 83] any claim that may be made upon the said Surety by reason of its suretyship as aforesaid." The appellees filed objections to the claim filed by the appellant. The

referee sustained those objections, and denied the claim of priority asserted by the appellant. The court approved that action of the referee.

The condition of the above mentioned bond, after a recital of the making of the above mentioned contract, follows: "Now Therefore, If the principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions and agreements of any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, and if said contract is for the construction or repair of a public building or a public work within the meaning of the act of August 13, 1894, as amended by act of February 25, 1905, shall promptly make payment of all persons supplying the principal with labor and materials in the prosecution of the work provided for in said contract, and any such authorized extension or modification thereof, then, this obligation to be void; otherwise to remain in full force and virtue." The bond, like the statute requiring it, has two purposes: 1. To secure to the Government faithful performance of the contractor's obligations to the Government; 2, to protect third persons who furnish labor and material to the contractor. The furnishers of labor or material for the work contracted are, like the Government, beneficiaries of the bond. Equitable Surety Co. v. McMillan, 234 U. S. 448, 454. In the absence [fol. 84] of a statute on the subject furnishers of labor or material to a contractor have the legal status of general creditors. Before the enactment of any Federal statute on the subject, it was not unusual for the Government to recognize the existence of a moral duty to protect furnishers of labor or material for a public work against dishonest or reckless contractors by requiring the insertion in a contract for such work of a provision requiring payment by the contractor of amounts owing by him to furnishers of labor or material for the work contracted for, or entitling the Government to withhold payments to the con-

tractor if he failed to pay promptly those who furnished labor and materials. Greenville Sav. Bank v. Lawrence, 76 Fed. 545. It appears from decisions referred to below that the Government's observance of that duty in practical and effective ways was the precursor of judicial recognition of an enforceable equitable right of unpaid furnishers of labor or materials for that work in or to a part of the contract price thereof remaining in the possession of the Government after the completion of that work by the contractor. Nothing contained in the statute in pursuance of which the bond on which appellant was surety was executed is inconsistent with the Government's recognition of the continued existence of a duty to protect furnishers of labor or material, with the result of making such furnishers beneficiaries of the funds withheld by the Government. The conclusion that, in the circumstances disclosed in the instant case, the appellees had claims on the fund in question superior to the claim asserted by the appellant is supported by the decision in the case of Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404. That case was a contest between the surety on the bond of a contractor for a public building and a bank which was the assignee of the contractor; the surety, after the completion of the building by the contractor and his failure to pay [fol. 85] amounts owing by him to furnishers of labor and materials for the building, having paid those amounts; and the contractor, pending performance of the contract, having assigned to the bank all payments which were then due, or might thereafter become due, on account of the contract, to secure the payment of a loan made by the bank to the contractor. The subject of the contest was a sum of money in possession of a United States official which was due under the contract after the completion of the building by the contractor. The bond given by the contractor, like the bond on which the appellant was surety, provided for the contractor making prompt payment to furnishers of labor or materials for the work contracted for. The court's opinion contained the statement, made in support of the expressed conclusion that the surety's equity was superior to that of the bank: "It paid the laborers and materialmen, and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see

that the laborers and supplymen were paid." Following that statement and a further discussion of the question presented, the court stated the conclusion that the surety by subrogation had a superior claim to the fund in question, without expressly stating to whose rights the surety was subrogated. As the contractor's obligation to the Government had been complied with before the surety paid the debts owing to furnishers of labor and materials, there was no right of the Government subject to be acquired by the surety by subrogation. The rights subject to be acquired by the surety by subrogation being those possessed by the furnishers of labor and materials, it is a reasonable, if not necessary, inference that the successful contestant's recognized superior right was acquired by subrogation to the rights of the furnishers of labor and material for the building contracted for. With reference to the last cited case the following was said in the opinion rendered in the case of Belknap Hardware & Mfg. Co. v. Ohio River C. Co., [fol. 86] 271 Fed. 144, 149: "When Henningsen's surety paid up, the United States, the secured creditor, had been satisfied, and had no further claim on the fund, unless it bore the duty to devote the fund to the labor and material claimants; hence the latter proposition must be considered as affirmed. Obviously, the retained fund is devoted to the payment for such labor and material as may be necessary to finish the work after the contractor defaults." As to the fund in court in the instant case, the appellant was not subrogated to any right of the Government, as the Government had no claim on the fund after the contractor had completed the work contracted for. The appellant was not subrogated to the rights of the appellees, as the debts owing to the latter by the contractor remained unsatisfied. The conclusion that the appellees, in the circumstances disclosed, have an equitable claim on the fund in question, superior to the claim asserted by the appellant, is supported by the decisions in the two cases last cited, and by other Federal decisions, including the following: In re: McGarry & Son, 240 Fed. 400; Cox v. New England Equitable Ins. Co., 247 Fed. 955; Alfred Richards Brick Co. v. Rothwell, 18 App. Cas. D. C. 516; Exchange State Bank v. Federal Surety Co., 28 Fed. (2), 485, 488.

The assignment and the indemnity agreement under which the appellant claims did not have the effect of sub-

ordinating the rights of the appellees to those of the appellant. The contractor being under an implied obligation to indemnify or reimburse the appellant, an express agreement to do so added nothing to appellant's rights. Hardaway v. National Surety Co., 211 U. S. 552; Springfield National Bank v. American Surety Co., 7 Fed. (2), 44.

The appellees being creditors of the appellant's assignor, the insolvent contractor, the appellant's claim is subordinate to those of the appellees for the additional reason that [fol. 87] the appellant, the surety of the insolvent debtor, is not, prior to the creditors being fully paid and satisfied, subrogated to rights or remedies the enforcement of which would operate to the prejudice or injury of the creditors. Jenkins v. National Surety Co., 277 U. S. 258; United States v. National Surety Co., 254 U. S. 73; State of Mississippi v. First Nat. Bank of Greenwood, 66 Fed. (2), 9; Peoples v. Peoples Bros., 254 Fed. 480; Glades County, Fla. v. Detroit Fidelity & Surety Co., 57 Fed. (2), 449.

The ruling in question was not erroneous. The order or decree appealed from is affirmed.

SIBLEY, Circuit Judge, dissenting:

The amended claim of American Surety Company asserted a prior lien on the fund paid to the contractor's trustee in bankruptcy by the United States. The objections of the materialmen asserted a prior lien in themselves and a right to be paid to the entire exclusion of the Surety Company, the fund being insufficient to pay all. The referee sustained the objections and ordered the materialmen to be paid first. This is the judgment which is to be affirmed. The Surety Company is at least a general creditor. The materialmen assert no priority under any provision of the Bankruptcy Act. They must and do assert a lien existing prior to bankruptcy. I see no basis for one [fol. 88] without judicial legislation. The majority opinion concedes, and it is undoubtedly true, that without the aid of a statute furnishers of labor and material to a contractor are merely his general creditors. While the Roman law was otherwise, the English law gave them no special right or lien either at law or in equity against the property improved or against the sum to be paid to the contractor. South Fork Canal Co. vs. Gordon, 6 Wall. at p. 571; Van-Stone vs. Stillwell, 142 U. S. 128; Prince vs. Neal-Millard

Co., 124 Ga. 884; 18 R. C. L., Mechanics' Liens, §1; 40 C. J., Mechanics' liens, §3. The insolvency of their debtor does not create any equity in them. Withrow Lumber Co. vs. Glasgow Inv. Co., 101 Fed. 863. Many American States have passed statutes giving a lien on varying conditions either against the property improved or against the money to be paid for the improvement. These statutes do not usually include public contracts, because the public property ought not to be sold on execution and because public officials ought not be harassed by garnishments or their equivalent. The protection most commonly afforded to suppliers of labor and material for public work is to require the contractor to give a bond conditioned for their payment. This was done as respects public work performed for the United States by the Act of August 13th, 1894, 40 U. S. C. A. § 270. Before that Act materialmen had no special rights in the money to be paid to the contractor, unless by some provision of the contract. Lawrence vs. United States, 71 Fed. 228. I am unable to see that the statute gives them any right except to share with the United States in the penalty of the bond. At first laborers and materialmen shared on a footing of equality with the United States, but a later amendment has postponed them. Nowhere and at no time has the statute given them any right to control the money coming to the contractor or any lien upon it. By the consent of the United States and the contractor expressed in their contract, special rights may arise as to the disposition of the money. An agreement [fol. 89] that some of it shall be withheld by the United States was dealt with in the leading case of Prairie State Bank vs. United States, 164 U. S. 227, before the statute was ever passed. At p. 233 it was said: "A stipulation in a building contract for the retention until the completion of the work of a certain portion of the consideration is as much for the indemnity of him who may be the guarantor of the performance of the work, as for him for whom the work is to be performed; it raises an equity in the surety to the fund created." The surety's equity was held to date back to the execution of the contract which required the retention, and thus to be prior to the contesting bank's later assignment. The surety was held to have an original right to be secured by the fund so set apart, and also a secondary equity to be subrogated to the right of the United States

to retain it. In Henningsen vs. United States Fidelity & Guaranty Co., 208 U. S. 404, which is mainly relied on in the majority opinion and in Belknap Hardware & Mfg. Co. vs. Ohio River Co., 271 Fed. 144, it is not stated whether or not the contract required the retention by the United States of the unpaid money, but one would suppose there was such a requirement because it was declared that Prairie State Bank vs. United States, supra, was in point, and that case went wholly upon the contractual segregation of the fund. The court in the Henningsen case speaks of subrogation but does not say to whose right the surety became subrogated, and the argument is sought to be made that since the contract was completed the United States no longer had any right when the surety paid out its money, so that the subrogation spoken of must have been to some right of the laborers and materialmen, who therefore must have been held to have a lien. But the headnote in the official report states: "In such a case the surety is subrogated to the rights of the contractor, but the bank is not." If that correctly states the ruling, the rights of the materialmen were not at all considered, and the ruling was [fol. 90] that the surety, bound since the date of his contract, was subrogated to the right of the contractor to collect the balance due on the completed contract, and the bank's assignment of date later than the contract was inferior, and the bank being a voluntary lender had no possible right of subrogation. Such a subrogation would work whether the unpaid balance was retained under the contract as a security for the surety or not, for the contractor's right to payment does not depend on such retention; and it would also seem that if it was so retained the surety would not need any subrogation because he had a direct and original right to be protected by the fund so set apart, it being a trust. Walker vs. Brown, 165 U. S. 654; Glades County vs. Detroit Fidelity and Surety Co., 57 Fed. (2d) at p. 452. The only way to arrive at a lien for the materialmen that I can see is to assume that money retained by requirement of the contract is for the security of them also. This has not yet been authoritatively held, and because of the number of laborers and materialmen might prove embarrassing to Government in settling up contracts. The contract ought clearly to indicate such a purpose. The present contract does not. It contains no requirement that

suppliers of labor and material be paid. The only reference in the contract to paying them is a provision that additional security on the bond protecting them can be required if the surety furnished should become unacceptable. The contract, like the statute, contemplates only the bond to secure them. The bond, of course, is conditioned to be void if the contractor fully performs the contract and in addition pays promptly all persons supplying labor and materials. If the contractor fails to pay any of them the surety must pay up to the penalty of his bond, but that is all. This it has done, and the bond and all its obligations are satisfied. The unpaid balances the contractor still owes, but the surety does not; and the contractor owes them because of the several contracts of purchase, not because of his bond or his contract with the United States. [fol. 91] This contract does provide for the retention of ten percent. of the payments to be made to the contractor, but gives discretion to stop retentions after fifty percent. of the work is satisfactorily done. Ten percent. of the contract price is $1524.00. Since the work was satisfactorily done only half of that, $762.00, was required to be retained. A discretionary retention is admitted to give rise to no rights in the materialmen in Alfred Richards Brick Co. vs. Rothwell, 18 App. Cas. D. C. 516. It follows that the trust fund is only $762.00, or at most $1524.00. This court has held that money not required to be retained is free money in the hands of the contractor upon which there is no trust or lien even in favor of the surety. Kane, Trustee, vs. First National Bank, 56 Fed. (2d) 534. I find nothing in this contract to show that the reserved percentages were for the benefit of anybody but the United States and the surety, as held in Prairie State Bank vs. United States, but if they were under trust also for the materialmen the trust covers at most $1524.00 and not the whole $2775.25 paid over by the United States.

In my opinion, under this contract and under the federal statute the materialmen have no special rights or lien either on the percentages contracted to be retained or on the free balance, but must be held to have credited the general responsibility of the contractor and the bond taken for their protection. The surety has a direct right, and also a right by subrogation, in respect of the retained percentages. I do not consider that the indemnity agree-

ment with the contractor contains an intelligible assignment of anything. The surety may be disentitled to have any relief by equitable subrogation until the materialmen are paid in full under principles asserted in Jenkins vs. National Surety Co., 277 U. S. 258, and LeFlore County vs. First National Bank, 66 Fed. (2d) 9. But that does not prevent an assertion of its direct right to the security of [fol. 92] the retained percentages, nor hinder its sharing with the materialmen, all as common creditors, in the bankrupt's general estate. I do not think the judgment totally excluding the surety is correct.

[fol. 93] No. 7382

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation,

versus

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a Corporation, et al.

Extract from the Minutes of February 13th, 1935

JUDGMENT

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Florida, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that the order or decree of the said District Court appealed from in this cause be, and the same is hereby, affirmed;

It is further ordered, adjudged and decreed that the appellant, American Surety Company of New York, a corporation, and the surety on the appeal bond herein, Hartford Accident and Indemnity Company, of Hartford, Connecticut, be condemned, in solido, to pay the costs of this cause in this Court, for which execution may be issued out of the said District Court.

SIBLEY, Circuit Judge, dissenting.

[fol. 94] UNITED STATES' CIRCUIT COURT OF APPEALS
FOR THE FIFTH DISTRICT

No. 7382

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation, Appellant,

versus

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a Corporation, et al., Appellees

On consideration of the application of the appellant in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable appellant to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, It is ordered that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that the certiorari petition, record and brief have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 6th day of March, 1935.

(Signed) N. P. Bryan, United States Circuit Judge.

[fol. 95] CLERK'S CERTIFICATE

UNITED STATES OF AMERICA:

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 80 to 94 next preceding

this certificate contain full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 7382, wherein American Surety Company of New York, a corporation, is appellant, and Westinghouse Electric Manufacturing Company, a corporation, et al., are appellees, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 79 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 6th day of March, A. D. 1935.

Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals, Fifth Circuit. (Seal United States Circuit Court of Appeals, Fifth Circuit.)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 29, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

FILED
MAR 27 19
CHARLES ELMORE C

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. [redacted] 12

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

FRANCIS B. CARTER,
Counsel for Petitioner.

J. E. D. YONGE,
DICKSON H. CARTER,
FRANCIS B. CARTER, JR.,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 819

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner and Appellant below,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.,

Respondents and Appellees below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

I.

Summary Statement of the Matter Involved.

M. J. Gray, trading as Gray Artesian Well Company, entered into a contract with the United States for drilling a well at the Naval Air Station at Pensacola, Florida (R. 8), and in connection therewith gave the bond required

by the Federal statute (40 U. S. C. A., Section 270) to the United States with petitioner, American Surety Company, as surety in the amount of $3,940 to indemnify the United States against loss on account of such contract and with condition that the contractor would promptly make payment to all persons supplying labor and materials used in the prosecution of the work under the contract (R. 19). As a part of the consideration for executing this bond, the contractor gave to petitioner in connection with it a written agreement of indemnity, by Paragraph VII of which he agreed that all monies which might be payable on account of his contract with the United States should be credited on any claim that might be made upon the surety by reason of its suretyship (R. 45). Gray completed the work under the contract, but remained indebted in a substantial sum to respondents who had furnished materials for use in the performance of the contract (R. 5). In a statutory proceeding in the United States District Court in Florida the surety (petitioner) paid into court the total penalty of its bond, $3,940, which in that proceeding was prorated among the creditors of Gray who had supplied him with labor and materials (R. 5); but this was not sufficient to pay these creditors in full, so that Gray remained indebted to them for the balance (R. 5). When Gray completed work on his contract the United States remained indebted to him for a portion of the contract price (R. 5), which amount petitioner sought to recover in a proceeding in the Supreme Court of the District of Columbia (R. 58). Gray had filed a petition in involuntary bankruptcy in the Northern District of Florida and his trustee in bankruptcy intervened in the proceeding in the District of Columbia and on his petition that court, declining to pass upon the surety's right to the fund, turned it over to the trustee in bankruptcy (R. 6). Petitioner filed its claim in the bankruptcy proceeding,

claiming an equitable lien and priority in the said fund (R. 25, 54). The creditors who had furnished materials in the performance of the contract and who claimed a lien on said fund (the respondents here) (R. 6) filed objections to the allowance of the lien or priority claimed by petitioner (R. 48, 60) and the referee in bankruptcy sustained their objection and allowed their claims priority of payment over petitioner (R. 63). The surety then filed its petition for a review by the United States District Court of the referee's order denying it priority (R. 64), and the District Judge sustained the referee's order (R. 66). Petitioner then appealed to the Circuit Court of Appeals for the Fifth Circuit and that court, by its judgment dated February 13, 1935 (R. 89), sustained the order of the District Court, and the writ of certiorari here sought is to review that order of the Circuit Court of Appeals. The substantial question presented to the Circuit Court of Appeals was whether the surety (petitioner here) or the suppliers of materials (respondents here) have the better right to the balance of the contract price which remained in the hands of the United States when the work under the contract was completed.

II.

Reasons Relied On for the Allowance of the Writ.

1. In holding that respondents, as furnishers of materials to the contractor, have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner, as surety on the contractor's bond, to said balance, the said Circuit Court of Appeals rendered a decision in conflict with the Circuit Court of Appeals for the Third Circuit in the case of *American Surety Company v. Finletter*, 274 Fed. 152, on the same matter.

2. In holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor in the hands of the United States upon completion of the construction contract, the said Circuit Court of Appeals rendered a decision in conflict with the Circuit Court of Appeals for the Eighth Circuit in the case of *Exchange State Bank* v. *Federal Surety Company*, 28 F. (2d) 485, and in conflict with the Circuit Court of Appeals for the Fourth Circuit in the case of *National Surety Company* v. *County Board of Education of McDowell County et al.*, 15 F. (2d) 993, and in conflict with the Circuit Court of Appeals for the Third Circuit in the case of *American Surety Company* v. *Finletter*, 274 Fed. 152, on the same matter.

3. In holding that petitioner, as surety on the contractor's bond, was not entitled to subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract, the said Circuit Court of Appeals has decided an important question of general law in a way probably in conflict with applicable decisions of this Court.

Wherefore, your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals for the Fifth Circuit had in the case numbered and entitled on its docket, Number 7382, American Surety Company of New York, a Corporation, Appellant, *vs.* Westinghouse Electric Manufacturing Company, a Corporation, *et al.*, Appellees, to the end that this cause may be reviewed and determined by this Court, as provided for by the statutes

of the United States; and that the judgment herein of said Circuit Court of Appeals for the Fifth Circuit be reversed by the Court, and for such further relief as to this Court may seem proper.

Dated March 20, 1935.

FRANCIS B. CARTER,
Counsel for Petitioner.

J. E. D. YONGE,
DICKSON H. CARTER,
FRANCIS B. CARTER, JR.,
Of Counsel.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 819

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner and Appellant Below,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.,

Respondents and Appellees Below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of Court Below.

The opinion of the Circuit Court of Appeals is printed in the record at page 80 and the dissenting opinion of Circuit Judge Sibley at page 85. These opinions have not yet been reported.

II.

Jurisdiction.

The judgment to be reviewed is a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, dated February 13, 1935 (R. 89). Being a judgment in a civil case

in a Circuit Court of Appeals it is one which under Section 347 of Title 28 of the United States Code may be reviewed by this Court by certiorari upon the petition of any party thereto.

III.

Statement of the Case.

The case has already been stated in the preceding Petition for Writ of Certiorari under I, (p. 1), which statement is hereby adopted and made a part of this brief.

IV.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that, as against the respondents, petitioner is not entitled to priority of payment of its claim against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract or to a lien upon said balance for its said claim.

2. The Circuit Court of Appeals erred in holding that, as against petitioner, respondents are entitled to priority of payment of their claims against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract.

V.

ARGUMENT.

Summary of the Argument.

Point A. The court below was in direct conflict with the decision of another Circuit Court of Appeals in holding that respondents as furnishers of materials to the contractor

have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner as surety on the contractor's bond.

Point B. The court below was in direct conflict with the decisions of three other Circuit Courts of Appeals in holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

Point C. The court below is in conflict with the applicable decisions of this Court in deciding that the petitioner as surety on the contractor's bond was not entitled by subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

Point A.

The court below was in direct conflict with the decision of another Circuit Court of Appeals in holding that respondents as furnishers of materials to the contractor have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner as surety on the contractor's bond.

The substantial question presented to the Court of Appeals was whether the surety (petitioner here) or the materialmen (respondents here) had the better right to the fund in question. The accounts of the materialmen had been

partially paid by the pro rata distribution among them of the full penalty of the bond paid into court by the surety and their claims were for the balance due them. The surety claimed on account of the payment it had been required to make under the bond. The fund in controversy was the balance of the contract price remaining in the hands of the United States after the contract was completed.

The Court of Appeals decided that the materialmen had "an enforceable equitable right" to the fund (R. 83, 84) and that such right was superior to the claim of the petitioner (R. 83, 84). Upon both of these points the decision was in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *American Surety Company* v. *Finletter*, 274 Fed. 152. That case involved the construction of public works for the City of Philadelphia. A bond including protection for laborers and materialmen similar to the bond required by the Federal statute and to the one before this Court was given upon an application, in substance, the same as was executed by the contractor here. The surety company paid to the labor and material claimants the full penalty of its bond but that amount was not sufficient to liquidate such claims in full. Both the surety and the materialmen claimed the balance retained by the city, the surety on account of the amounts already paid under its bond and the materialmen on account of the unpaid balance on their claims.

As to the materialmen's right, the court said (text page 155):

> "In this state of the law—laborers and materialmen having no rights to reserved percentages—there were, as to them, no rights to which the Surety Company could be subrogated."

The court further held that the surety was entitled to the fund under its equitable assignment, saying on this point:

"Without discussing the views there expressed with reference to a valid equitable assignment, we are inclined rather to the views of the same court expressed in *Ingersoll* v. *Coram*, 211 U. S. 335, accepting the rule stated in *Walker* v. *Brown*, 165 U. S. 654, to the effect that an express executory contract in writing, whereby the contracting parties sufficiently indicate an intention to make some particular property or fund therein described or identified, a security for a debt or other obligation, creates an equitable lien on the property so indicated."

An examination of the court's opinion in the *Finletter* case will show that the decision there was in favor of the surety and against the materialmen where, as here, the surety had paid the full penalty of its bond to the materialmen without liquidating their claims in full and left them claiming for the remainder in competition with the surety, who claimed, as here, on account of the amounts already paid under its bond. This situation appears in the controversy as to the Fifty-fourth Street Bridge (text 157) and particularly in connection with the claim of American Bridge Company. The bonding company under that particular construction contract had paid the receiver the full amount of its obligation, with which fund the receiver paid a 65% dividend, leaving 35% of the claim of the Bridge Company unpaid. For this balance the Bridge Company came into competition with the Surety Company and the court held against the Bridge Company, just as it had already held against the receiver. But the payment of the whole of the reserved fund to the bonding company did not liquidate its claim in full; for the balance it presented a claim as a general creditor. The Bridge Company likewise presented its claim as a general creditor for the remaining balance of 35% due it after deducting its share of the proceeds of the bond. As between these two claimants

as general creditors, the court held, upon general principles of subrogation, that the bonding company must wait until the other general creditors had been paid in full. It is made entirely clear, however, that this situation arose only after the bonding company had received the whole of the reserved precentage.

Though the *Finletter* case arose under a bond required by a State statute and the bond in the instant case was given under the Federal statute, the bonds and the application therefor and the facts on which the conflicting claims arose are in substance the same in the two cases and the decisions of the two courts of appeal thereon are in direct conflict.

POINT B.

The court below was in direct conflict with the decisions of three other Circuit Courts of Appeals in holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

By express contract with the contractor, made in his application for the bond, petitioner became entitled to the benefit of all monies which might be due under the construction contract for credit upon any claim that might be made against it by reason of its suretyship (R. 45, Paragraph VII). The Court of Appeals, however, declined to give any effect whatever to this agreement, holding that it added nothing to the implied obligation of indemnity. It said:

> "The assignment and the indemnity agreement under which the appellant claims did not have the effect of subordinating the rights of the appellees to those of

the appellant. The contractor being under an implied obligation to indemnify or reimburse the appellant, an express agreement to do so added nothing to appellant's rights."

It is clear that a mere general agreement by the principal to indemnify the surety adds nothing to the obligation implied by law from the relationship; but this ignores all of the other terms of the express contract. In holding that this contract gave the surety no lien or prior right in the fund, the Court of Appeals is in conflict with the courts of appeals in three other circuits, each of which has held that such an agreement gives the surety such a lien or priority.

The Circuit Court of Appeals for the Eighth Circuit had before it in *Exchange State Bank* v. *Federal Surety Company*, 28 F. (2d) 485, an application for a bond containing an indemnity agreement in substance the same as the agreement in the instant case. There the fund remaining in the county's hands was claimed by the surety under an equitable lien based upon the assignment in the contractor's indemnity agreement and was claimed by the appellant bank under an assignment from the contractor to secure a loan of funds used by him for labor and materials. The court held that the surety had an equitable lien on the fund under the assignment agreement and that this lien arose at the time of the execution of the bond and was superior to any claim of the bank.

The Circuit Court of Appeals for the Fourth Circuit had before it in *National Surety Company* v. *County Board of Education*, 15 F. (2d) 993, a case similar to ours, in which the contractor had made an indemnity agreement with the surety in the application for the bond by which the deferred payments and retained percentages and all other moneys that might become due to the contractor under the contract were assigned to the surety. Upon completion of the contract the school board paid over a portion of the unpaid bal-

ance of the contract price to the contractor, another portion to a bank to whom the contractor had made an assignment, and the remainder to persons who had supplied materials to the contractor for the building. The surety sued the board for all of these funds, claiming that it was entitled to an equitable lien upon them in the hands of the county under its assignment. The court held that the surety had such a lien and said.

> "We agree with the standing master that complainant (the surety company) is entitled to a decree for the entire amount of the percentage required to be retained. Complainant's loss under the bond exceeds this amount, and it is well settled that in cases such as this the surety has an equitable lien on the funds required by the contract to be retained from payments to the contractor, to the extent necessary to reimburse the surety for loss sustained under the bond."

After citing and discussing authorities including the *Henningsen* case (hereinafter discussed), the court continued:

> "In the case at bar, not only did the contract provide for the retention by the defendants of 15% of the contract price, but this retained percentage was assigned to plaintiff to secure any loss arising out of the execution of the bond. This assignment unquestionably created in favor of complainant an equitable lien upon the retained percentage so assigned."

The conflicting decision from the Third Circuit is *American Surety Company* v. *Finletter*, 274 Fed. 152, which we have already discussed (pp. 10-12).

We respectfully submit that this conflict of authority as to the legal effect of a form of agreement in common daily use in business should be settled by this Court.

Point C.

The court below is in conflict with the applicable decisions of this Court in deciding that the petitioner as surety on the contractor's bond was not entitled by subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon completion of the construction contract.

The court below held that petitioner was not entitled to the fund in question by subrogation because any subrogation must be to the rights of the respondents as suppliers of materials and, since the whole of their debts had not been satisfied, petitioner could not claim by subrogation through them. This decision was based upon the court's construction of the decision of this Court in *Henningsen* v. *U. S. Fidelity and Guaranty Company*, 208 U. S. 404. That case grew out of a construction contract with the United States under which a bond was given in accordance with the Federal statute including protection for suppliers of labor and materials. The contractor completed the construction but failed to pay certain labor and material claims. The surety paid the full penalty of its bond and those claims were satisfied. Because of this payment the surety asserted a right to the reserved fund held by the United States as against a bank which held an assignment of this fund from the contractor. This Court held that the surety was entitled to the fund in equity.

Following the construction of that case given in *Belknap Hardware & Manufacturing Company* v. *Ohio River Contract Company*, 271 Fed. 144, the Court of Appeals reached the conclusion that this Court had held in the *Henningsen* case, that the rights to which the surety was there held to be subrogated were those of the furnishers of materials. This we submit is an erroneous conclusion. The Court of

Appeals did not consider at all the possibility that the subrogation was to the rights of the contractor, who, having completed the contract, had the right to collect the fund in question. That it was the contractor's right to which the surety was subrogated is expressly stated by the headnote in the official report of the case. This construction is clearly stated in the dissenting opinion below as follows (R. 87):

> "The court in the *Henningsen* case speaks of subrogation but does not say to whose right the surety became subrogated, and the argument is sought to be made that since the contract was completed the United States no longer had any right when the surety paid out its money, so that the subrogation spoken of must have been to some right of the laborers and materialmen, who therefore must have been held to have a lien. But the headnote in the official report states: 'In such a case the surety is subrogated to the *rights of the contractor*, but the bank is not.' If that correctly states the ruling, the rights of the materialmen were not at all considered, and the ruling was that the surety, bound since the date of his contract, was subrogated to *the right of the contractor to collect the balance due* on the completed contract, and the bank's assignment of date later than the contract was inferior, and the bank being a voluntary lender had no possible right of subrogation."

Soon after the decision in the *Henningsen* case this Court again held in *Hardaway* v. *National Surety Company*, 211 U. S. 552, which was on similar facts, that the surety was entitled to the reserved payment by subrogation. Again the opinion did not state to whose rights he was subrogated, but the headnote again stated that it was to the contractors' rights.

This erroneous construction of the holding in the *Henningsen* case has resulted in the denial to petitioner of the right of subrogation; and the decision below should,

we submit, be reviewed to bring it into conformity with the decisions of this Court correctly construed. If there be doubt as to the true meaning of the *Henningsen* decision, a review should be had in this case to ascertain and announce the true rule.

Conclusion.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers and for the granting of a writ of certiorari and the review and reversal of the decision of the Court of Appeals.

FRANCIS B. CARTER,
Counsel for Petitioner.

J. E. D. YONGE,
DICKSON H. CARTER,
FRANCIS B. CARTER, JR.,
Of Counsel.

(6127-C)

FILE COPY

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 12

AMERICAN SURETY COMPANY OF NEW YORK,
A CORPORATION,
Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.

BRIEF FOR THE PETITIONER.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 12

AMERICAN SURETY COMPANY OF NEW YORK,
A CORPORATION,
Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.

PETITIONER'S BRIEF FOR USE UPON ARGUMENT OF CASE.

Opinion of the Court Below.

The majority opinion of the Circuit Court of Appeals is reported at page 377 of 75 Fed. (2d), and the dissenting opinion of Circuit Judge Sibley at page 380 of the same volume. These opinions appear in the Record at pages 80 and 85.

Jurisdiction.

The judgment to be reviewed is a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, dated February 13, 1935 (R. 89). Being a judgment in a civil

case in a Circuit Court of Appeals, it is one which under Section 347 of Title 28 of the United States Code may be reviewed by this Court by certiorari upon the petition of any party thereto. Certiorari was granted by this Court on April 29, 1935.

The Statute Involved.

The statute involved will be found in the Appendix *infra*, pp. 50, 51.

Statement of Facts.

This case comes before this Court on writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit to review a judgment affirming a judgment of the District Court of the United States for the Northern District of Florida in favor of certain materialmen, respondents herein.

On November 8, 1930, M. J. Gray, trading as the Gray Artesian Well Company, entered into a contract with the United States Government for drilling a well at the Naval Air Station at Pensacola, Florida. The contractor gave a bond executed by the petitioner, the American Surety Company of New York, as surety, to the United States Government.

At the time that the contractor made application to the Surety for the bond in question, he gave to the Surety a written contract of indemnity, by Paragraph 7 of which it was agreed that in case of default by the contractor all moneys which might be payable on account of the contractor's contract with the Government should be credited upon any claim that might be made upon the Surety by reason of its undertaking (R. 45). The bond was given in the penal sum of $3940 and was conditioned upon the contractor's faithful performance of his contract to the Government and

upon prompt payment by the contractor to all persons furnishing labor and materials used in the prosecution of the project. The contract between the Government and the contractor authorized the Government to retain 10% of the total contract price until final completion and acceptance of the contract, provided, however, that after satisfactory completion of 50% of the work the remaining payments might be made in full (R. 17).

Gray completed the project but remained indebted in the sum of $5677.85 to the respondents who had furnished materials for use in the performance of the contract (R. 5). In a statutory proceeding in the District Court of the United States for the Northern District of Florida, the Surety paid into court the total penalty of its bond which was distributed ratably among the respondents. This sum, however, was not sufficient to pay them in full (R. 5).

At the time the contractor completed his contract the Government was indebted to Gray in the amount of $2724.23 as the balance due under the contract (R. 5), which amount the petitioner sought to recover in a proceeding in the Supreme Court of the District of Columbia (R. 58). One of the respondents, Runyon-Cobb Boiler Works, intervened in that proceeding, urging its superior equity in the fund. Gray had filed a petition in involuntary bankruptcy in the United States District Court for the Northern District of Florida. His trustee in bankruptcy also intervened in the District of Columbia proceeding. On the trustee's petition the District of Columbia court declined to pass upon the rights of the respective litigants to the fund and turned it over to the trustee in bankruptcy (R. 6). The petitioner duly filed its claim in the bankruptcy proceedings claiming an equitable lien and priority in the fund (R. 25, 54). The respondents asserted an equitable lien on the fund (R. 6), and filed objections to the allowance of the lien or priority claimed by the petitioner (R. 48, 60). The referee in bank-

ruptcy sustained their objections and allowed the respondents' claim of priority (R. 63).

The Surety then filed a petition with the United States District Court of the Northern District of Florida for a review of the referee's order (R. 64), and the District Judge affirmed that order (R. 66). The petitioner then appealed from the court's judgment to the United States Circuit Court of Appeals for the Fifth Circuit and that court by its judgment, dated February 13, 1935 (R. 89), sustained the order of the District Court. Whereupon the petitioner filed in this court its petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit, which was granted on April 29, 1935 (R. 91).

Questions Presented.

The issues raised by this case are:

1. Has the Surety a prior claim as against the suppliers of materials to the fund now in court?

2. Have the materialmen a priority in the fund which entitles them to receive that fund?

3. If the Surety is denied a preferred claim to the fund, can it prove its claim and share ratably with materialmen and other general creditors in the distribution of the fund?

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that, as against the respondents, petitioner is not entitled to priority of payment of its claim against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract or to a lien upon said balance for its said claim.

2. The Circuit Court of Appeals erred in holding that, as against petitioner, respondents are entitled to priority of payment of their claims against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract.

Summary of Argument.

The question before this Honorable Court is one of competing equities in the reserved fund, as between the petitioner Surety and the respondent materialmen.

The Surety will first show the basis of its claim for preference to the fund. The Surety is entitled to the fund, first, because it has a direct right to the fund by reason of the law of indemnity; second, by virtue of principles of law analagous to those of subrogation; and, third, because a failure to pay this fund to the Surety would impair its rights under its original contract with the contractor and would bring about a failure of consideration. (Point I.)

The Surety will then show that the respondent materialmen have no priority to the fund now in court. The petitioner will argue that the materialmen have no equitable lien on the reserved fund as a result of any express contract or by reason of any applicable statute or by way of implication. It will be shown that the respondents are only general creditors of the contractor in so far as the rights of the Surety are concerned. (Point II.)

Finally, the petitioner will contend that even if it has no superior right to the fund, it should nevertheless, be allowed to share ratably with materialmen and other general creditors in the distribution of the fund. (Point III.)

ARGUMENT.

Point I.

The Surety is Entitled to the Reserved Fund.

(A).

The Surety Has a Direct Right to the Fund.

It is elementary that a surety which has paid out money by reason of its undertaking has certain well recognized remedies by which it may seek to satisfy or mitigate its losses. Subrogation, indemnity and reimbursement are the usual remedies. These rights are independent of each other and are characterized by their own peculiar attributes. However, all of these remedies are predicated upon certain fundamental principles which underlie all of the various means by which it is sought to save a surety harmless from legitimate risks. The surety's rights are either direct or derivative.

(1) *By the law of indemnity the Surety has a direct right to the reserved fund.*

The decisions are clear that a contract of indemnity creates certain direct rights against the principal or against the security given by such agreement. It is not a collateral undertaking—it is a positive and distinct right arising from an express agreement or from certain circumstances to which the courts attach an implied agreement of indemnification.

Howell v. Commissioner of Internal Revenue, 69 F. (2d) 447, 450 (C. C. A. 8th, 1934), cert den. 292 U. S. 654, 78 L. Ed. 1503.

Somers v. *U. S. F. & G. Co.*, 191 Calif. 542, 547; 217 Pac. 746 (1923)

Wolthausen v. Trimpert, 93 Conn. 260, 265; 105 Atl. 687 (1919).

See:

Brandt: The Law of Suretyship & Guaranty—Vol. 1, Sec. 5 (2d ed. 1905).

In the instant case the principal and the surety have by specific agreement created a direct right to the fund in question. The contract of indemnity stipulates:

> "• • • and the Indemnitor further agrees in the event of any breach or default on his part in any of the provisions of any contract covered by the suretyship of the said Surety, • • • that deferred payments and any and all moneys and securities that may be due any payable at the time of such default, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract, shall be credited for any claim that may be made upon the said Surety by reason of its suretyship as aforesaid" (R. 34), 41.

The conclusion is inescapable that the true import of this contract was to create in the Surety a right to and an interest in "any and all money and securities that may be due and payable at the time of such default". It is, of course, imperative to the materialmen's claim to insist that a failure on the part of the contractor to pay their claims constitutes a default under the contract. If this be true, the very contingency which the contract of indemnity was designed to meet has taken place. It follows as a natural and proper consequence that the Surety has a direct right by reason of that agreement to all funds due and payable to the contractor. The contract is fairly susceptible of no other interpretation—that is its plain meaning. As such it is consistent with the intent of the parties and is violative of no principles of law. In view of these

unalterables, we respectfully suggest that no court should allow this agreement to be rendered an idle gesture or that its evident purposes be thwarted.

Judicial sanction for these principles is abundant. The authorities recognize such agreements as creating a direct right in the Surety which is cognizable and enforceable by the courts.

Lacy v. *Maryland Cas. Co.*, 32 Fed. (2nd) 48 (C. C. A. 4th, 1929).

In re Dailey, 19 Fed. (2d) 95 (D. C. N. J., 1926).

Tennant v. *United States F. & G. Co.*, 17 Fed. (2d) 38 (C. C. A. 3d, 1927).

Globe Indemnity Co. v. *Unity Railways Co.*, 272 Fed. 607 (C. C. A. 3rd, 1921).

New Amsterdam Cas. Co. v. *City of Astoria*, 256 Fed. 560 (D. C. Ore., 1919).

Robinson v. *Blaylock*, 192 N. C. 407, 135 S. E. 136 (1926).

While some of these cases do not involve any question of competing equities between a surety and materialmen, they, nevertheless, indutiably show the interest of a surety in a reserved fund. All are direct authority for the proposition that a surety has by reason of its contract of indemnity a direct right in the reserved fund which will be zealously protected by the courts.

(2) *The Surety has an implied right of indemnity, even though there be no express contract creating such a right.*

It was decided as early as 1633 that the principal was bound by implication to reimburse the surety—a counter-bond of indemnity was implied from the relationship of the parties.

Ford v. Strowbridge, Nelson Ch. 24 (1633).

Since that date the courts have decided times without number that upon the execution of a contract of suretyship there arises in the absence of an express agreement to the contrary an implied contract that the principal will indemnify the surety for any payment made in compliance with the suretyship undertaking.

Millette Farmers El. Co. v. *H. Poehler Co.*, 18 Fed. (2d) 430 (D. C. Minn., 1927).

Springfield Natl. Bk. v. *American Surety Co.*, 7 Fed. (2d) 44 (C. C. A. 6th, 1925).

In re Stout, 109 Fed. 794 (D. C. W. D. Mo., 1900).

(3) *An express contract of indemnity does not detract from the Surety's implied right of indemnity.*

There are decisions to the effect that an express contract of indemnity gives the surety no greater right than the implied obligation of the principal to indemnify, which the surety always has in the absence of an agreement to the contrary. Such cases purport to hold an express agreement in substance is surplusage.

Maryland Casualty Co. v. *Fouts*, 11 Fed. (2d) 71 (C. C. A. 4th, 1926).

Springfield v. *American Surety Co., supra.*

But whether they be sound or not, this much is clear—an express agreement of indemnity does not detract from any of the Surety's implied rights of indemnity. Such a contract is not a boomerang for the Surety—it does not serve to diminish rights that the Surety would otherwise have.

It thus appears that irrespective of whether it be determined that the Surety has a right of indemnity as a result of its express contract or because such a right is implied, the Surety has a direct right in the reserved fund by either of the above approaches.

(4) *The Surety has a greater right to the reserved fund under principles of indemnity than it has by the law of subrogation.*

It was urged by respondents below that the indemnity agreement gives the Surety no greater right than it would have on principles of the law of subrogation. As authority for this contention respondents rely upon the decision of this court in *Jenkins* v. *National Surety Co.* (277 U. S. 258, 72 L. Ed. 874, 1928). A careful analysis of that decision reveals that it is not applicable in the present case. In that case the Surety sought to share with other creditors in the distribution of the insolvent principal's estate on the basis of its indemnity agreement. The court denied the Surety's claim, until it was shown that the beneficiaries under the bond had been paid in full. The contract of indemnity in the Jenkins case, however, was very general in character. It was only a promise to indemnify the Surety for its losses out of the general assets of the principal's estate. No particular fund or asset of the principal was segregated or charged with a liability to reimburse the Surety. There was no definite appropriation of specific property to meet a potential liability. No trust fund was set up to meet any possible losses. In the case at bar the principal definitely set aside this fund as security for repayment of the Surety's losses. The present contract of indemnity is in the nature of a mortgage on after-acquired property.

Barnes v. *Alexander*, 232 U. S. 117, 121, 58 L. Ed. 530 (1914);

Holroyd v. *Marshall*, 10 H. L. Cas. 191, 211 (1862);

Blair: The Allocation of After-Acquired Mortgaged Property Among Rival Claimants, 40 Harv. L. Rev. 222 (1926).

It may be said that the effect of the contract of indemnity in the Jenkins case likewise had the effect of charging all of

the principal's assets with payment of any loss that the Surety might incur as a result of the excution of the bond. We suggest, however, that a distinction may well be made between the legal effect given to an instrument which impairs the security from which creditors always have a right to satisfaction and that which is given to an agreement which in no way affects any present assets of the principal, and which does not threaten any property to which the creditors have a right to look for payment. Courts in analogous cases have refused to disturb such agreements. It is well settled that a creditor cannot object to assignments or contracts of the principal dealing with a potential inheritance that he may receive. By like reasoning it would seem that the materialmen or other creditors could not challenge a contract such as we have in the present case.

An even more significant distinction is the fact that in the Jenkins case allowance of the Surety to participate in the assets of the principal along with the creditors who were the beneficiaries on the bond would deprive those creditors of assets which were unquestionably a part of the principal's estate and to which they were entitled to look for payment. Those assets were the properties to which the creditors should first look for payment. They were the primary source. Whereas, in the instant case the reserved fund has never become a part of the principal's estate—it has never come into the principal's hands. This fund had been encumbered before it came into actual existence with a primary equity in the United States Government for faithful performance of the contractor's contract and a secondary equity in the Surety Company for reimbursement of all expenditures made by the Surety in accordance with its bond. All rights or interest which the principal had or might acquire in this fund were necessarily subject to these superior equities. At best, the only right that the contractor ever had in this fund was conditioned upon the discharge of the two prior obliga-

tions. His failure to discharge both of those obligations extinguished every vestige of right that the contractor might ever have had in the fund. It thus appears that our problem is not one of competition between the Surety and the assured in the general assets of the principal as was the case in *Jenkins* v. *National Surety Company, supra,* but rather a situation where the general creditors lay claim to a fund which had been specifically appropriated to the Surety long before their claims came into existence and which was never a part of the principal's assets. The Surety's and materialmen's claims to this fund are not predicated on the assumption that the fund is a part of the principal's estate—their claims are made independently and in disregard of the principal. The materialmen purport to claim the fund on the ground that they have an equitable lien on the property—the Surety lays claims to the fund since it has a direct right to the fund.

From what has been said it follows that the Surety's claim to a priority in the reserved fund is not at war with the fundamental principle that a surety cannot be subrogated against its creditor. This precept is implicit in the *ratio decidendi* of the Jenkins case. As has been pointed out, there is no competition between the Surety and the materialmen since the Surety claims a fund to which the materialmen have no claim. (See Point II, p. 31, *infra.*)

That a surety is not entitled to be *subrogated* to the rights of its creditor until payment in full has been made is elementary. The weight of authority does not countenance *pro tanto* subrogation. This principle has no place in the law of indemnity or reimbursement. A surety may enforce its right of *indemnity* even though it has not paid the beneficiaries in full. Complete satisfaction of the creditors is not a condition precedent.

In re Kimbrough-Veasey Co., 292 Fed. 757 (D. C. N. D. Ga., 1923);

Jefferson v. *Century Sav. Bk.*, 143 Iowa 83, 120 N. W. 308 (1909);
Vermeule v. *York Cliffs Imp. Co.*, 105 Me. 350, 74 Atl. 800 (1909);
Bullock v. *Campbell*, 9 Gill (Md.) 182 (1850);
Hall v. Hall, 10 Humph. (Tenn.) 352 (1849);
Stearns: The Law of Suretyship, p. 508 (4th ed., 1934).

Judge Sibley adopts this view in his dissenting opinion. He says (R. 89):

> "• • • The surety may be disentitled to have any relief by equitable subrogation until the materialmen are paid in full under principles asserted in *Jenkins v. National Surety Co.*, 277 U. S. 253, and *LeFlore County v. First National Bank*, 66 Fed. (2d) 9. But that does not prevent an assertion of its direct right to the security of the retained percentages, nor hinder its sharing with the materialmen, all as common creditors, in the bankrupt's general estate. • • •"

(5) *The Surety's right of indemnity to the reserved fund attached at the time that the contract of indemnity was executed.*

It has been shown that by principles of the law of indemnity the Surety has a direct right to the reserved fund. The time at which that right arises, therefore, becomes pertinent. The law is clear that upon the execution of the contract of suretyship certain inchoate rights come into existence. These rights remain embryonic until some contemplated contingency materializes. It is at that time that these rights crystalize and become enforceable by the courts. These rights came into existence at the time that the suretyship obligation arose. Their efficacy dates from

their birth or inception, and not from the time of their maturity.

Prairie State Nat'l Bank v. *U. S.*, 164 U. S. 227, 41 L. Ed. 412 (1896);

U. S. F. & G. Co. v. *Centropolis Bk.*, 17 Fed. (2d) 918 (C. C. A. 8th, 1927);

American Surety Co. v. *National Bank*, 17 Fed. (2d) 942 (D. C. S. D. Ohio, 1925);

Griffin v. *Long*, 96 Ark. 268, 131 S. W. 672 (1910);

Labbe v. *Bernard*, 196 Mass. 551, 52 N. E. 688 (1907);

Sheldon: The Law of Subrogation, Sec. 102, p. 115 (1882).

In *American Surety Company* v. *National Bank, supra*, the court said at page 944:

> "The written application, signed by the bank, through its officers, accepted by the surety company, evidenced by the issuance of the surety bond thereon, constituted a contract of indemnity, limited to the terms of indemnity expressed therein. The relationship of debtor and creditor between the bank and surety company was created on the acceptance of the application by the surety company. Liability dated from that moment. The question of amount of that liability became a determinable factor only after default upon the bond by the bank and the payment of the surety liability by the surety company."

Some courts have termed this metamorphism as the "relation back" theory. They reason that since the Surety has certain inchoate rights from the date of entering into the suretyship undertaking that upon performance of its obligations all rights accruing thereby relate back to the time when the contract was made. Mr. Justice Sheldon, in *Labbe v. Bernard, supra*, expressed it in this way:

> "While it is true that the rights of the sureties to the remedies of the principal do not become complete

and are incapable of enforcement until they have discharged their principal's obligation, yet their right becomes an inchoate one as soon as they have entered into the relation of suretyship; and their equitable assignment of their principal's rights and remedies, when completed by the performance of his obligation relates back * * * to that earlier time."

Thus in the case at bar the Surety upon giving its bond received in return certain inchoate rights which became consummate at the time the contractor defaulted on its contract by failure to pay materialmen. It was then that the Surety's direct right to the reserved fund became complete, but that right related back to the time of its genesis, and takes effect as of that date. Any right or interest that the materialmen might have in the reserved fund is, therefore, necessarily subsequent and subject to the prior right of the Surety unless the materialmen are given some superior equity by statute. No applicable statute creates such a right. (Point II, p. 32, *infra.*)

The respondents have argued below that the principles of "relation back" are not applicable in this case. They assert in effect that although the "relation back" theory might apply in certain cases, it cannot be invoked in a case where its application would defeat "the collateral rights of third persons". The respondents' argument completely befogs the issue. Our problem is not whether intervening rights of third persons may be cut off by the "relation back" theory, but rather have the third persons any rights to be cut off by operation of the "relation back" doctrine. It will be shown that the respondents have no rights or interests in the reserved fund. (Point II, p. —, *infra.*) If the respondents have no right in or claim to the reserved fund, there is no justification for preventing the natural operation of the "relation back" theory. Nor can it be said that it affects a frustration of the ends of justice,

since the materialmen are possessed of no rights which may thus be damaged or jeopardized.

The argument of the respondents is circular and make-believe to the ultimate. First in some inexplicable manner they create a right in the materialmen to the fund. This they dignify as an equitable lien. A right having been created, they then recite that the "relation back" theory is not pertinent because it would defeat those *rights* of the materialmen. It is submitted that since the materialmen have no interest in the reserved fund, as will be shown (Point II, p. 16, *infra*), there is no force in the respondents' suggestion that the "relation back" theory is inapplicable.

However, the soundness of the respondents' general proposition may well be doubted when it is considered that the Surety was allowed to prevail by reason of the relation back theory over the intervening rights of the assignee banks in *Prairie State Bank v. United States*, *supra*, and in *Hemmingsen v. United States F. & G. Co.*, 208 U. S. 404; 52 L. Ed. 547, (1908). Their rights, if any, were wiped out by giving effect to the Surety's inchoate right of subrogation.

It should also be pointed out that in the final analysis it makes no essential difference whether it is said that the Surety has a direct right in the reserved fund by virtue of its contract of indemnity or as a result of governing principles of the law of reimbursement or of equitable assignment. For the purposes of this case it is largely a matter of nomenclature.

American Surety Co. v. *Finletter*, 274 Fed. 152, (C. C. A. 3rd 1921);

Pratt Lumber Co. v. *T. H. Gill Co.*, 278 Fed. 783, 798, (D. C. N. C. 1922);

See: *McKallip* v. *Altoona*, 265 Pa. 192, 108 Atl. 408 (1919).

The respondents argued that if the contract of indemnity be construed as an equitable assignment the Surety, as an assignee, would receive no greater rights than the assignees received as assignees in *Henningsen* v. *United States F. & G. Co., supra,* and in *Hardaway* v. *National Surety Company* (211 U. S. 552, 53 L. Ed. 321, 1909). This is unsound. The claims of the assignees in the Henningsen case and in the Hardaway case were denied because the surety had certain inchoate rights in the fund just as the Surety has in the present case. The Surety's rights were held to be superior to the rights of the assignees. In the present case if the Surety is an assignee, it is not competing with a creditor who has any inchoate rights or any direct rights to the fund, but rather with a claimant who has no right whatever to the fund. (Point II, p. 31, *infra*). The analogy attempted to be drawn by the respondents from the Henningsen and Hardaway cases must fail.

A study of the apposite cases reveals that although the courts have pursued somewhat diverse processes of reasoning in arriving at their ultimate conclusion in these cases, nevertheless, they are all in accord, with a few explainable exceptions, in their final result, which gives the surety a direct right to the reserved fund. Some courts have reached their decision by the vehicle of recognizing the express or implied contract of indemnity, others have used the *modus* of reimbursement, while others have relied upon the law of equitable assignment. The inarticulate major premise in all of these cases seems to be the recognition of the fundamental equity of the surety. Of course, it is true that in many of these cases there was no contest between a surety and materialmen, but that fact does not destroy their intrinsic value as a guide to the correct determination of the rights of a surety in similar situations. Those cases are all authorities for the proposition that the surety has a right

to a reserved fund. These decisions are based upon fixed principles of law and not upon the personality of the litigants in the particular case.

(6) *The Surety has an equitable lien on the reserved fund.*

Equitable liens may be created by express contract or they may be implied because equitable considerations demand such in order to prevent injustice.

Pomeroy, Equity Jurisprudence, Vol. 3, Secs. 1235, 1238 (3d ed. 1905).

Where there is a distinct appropriation of certain property with the intention that it shall secure the payment of a debt or obligation, an equitable lien is thereby placed on the property.

Ingersoll v. *Coram,* 211 U. S. 335; 53 L. Ed. 208 (1908); *Walker* v. *Brown,* 165 U. S. 654; 41 L. Ed. 865 (1897).

In *Walker* v. *Brown, supra,* the court cited with approval this language from Pomeroy's Treatise on Equity Jurisprudence (p. 664 of 165 U. S.):

> "The doctrine may be stated in its most general form that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund, therein described or identified, a security for a debt or other obligation, or whereby the party promises to convey or assign or transfer the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands, not only of the original contractor but of his heirs, administrators, executors, voluntary assignees, and purchasers or encumbrancers with notice * * *."

The contract of indemnity plainly creates an equitable lien for the Surety on the reserved fund. The agreement satisfies all of the elements that are necessary to establish an equitable lien. By that agreement there is a segregation of certain property; there is a definite identification of that property; and there is a manifest intention on the part of the parties to have the fund become security for any loss that the Surety may suffer in the undertaking.

The decisions are legion which sustain the equitable right of the surety to a reserved fund that has been set aside by the provisions of the original contract between the governmental agency and the contractor.

Prairie State Bank v. *United States, supra*
Globe Indemnity Co. v. *Unity Railways, supra*
Reid v. *Pauly*, 121 Fed. 652, (C. C. A. 9th, 1903)
Wasco County v. *New England E, Ins. Co.*, 88 Oreg. 465; 172 Pac. 126 (1918)

Mr. Justice White, speaking for the court in *Prairie State Bank* v. *United States, supra*, at page 233 said:

> "That a stipulation in a building contract for the retention, until the completion of the work, of a certain portion of the consideration, is as much for the indemnity of him who may be guarantor of the performance of the work as for him for whom the work is to be performed; that it raises an equity in the surety in the fund to be created; and that a disregard of such stipulation by the voluntary act of the creditor operates to release the sureties, is amply sustained by authority. • • •"

Since the Surety has a direct right as a consequence of its equitable lien on the fund in question, and since that direct right came into existence at the time that the suretyship contract was made, it is submitted that the Surety is entitled to receive the retained fund.

B.

EQUITABLE PRINCIPLES ANALOGOUS TO SUBROGATION DEMAND THAT THE SURETY SHOULD HAVE THE RESERVED FUND.

Even if it be assumed that the Surety has no direct right to the fund in court, still the petitioner would be entitled to the fund on principles which closely parallel those of subrogation. There is the highest authority to the effect that a surety in a position similar to that of the petitioner is "subrogated to the rights and remedies of the contractor".

Hardaway v. *National Surety Company, supra.*

Henningsen v. *U. S. F. & G. Co., supra.*

Johnson Service Co. v. *Monin,* 253 N. Y. 417; 171 N. E. 682 (1930).

Illinois Surety Co. v. *City of Galion,* 211 Fed. 161, 163. (D. C. N. D. Ohio, 1913).

Wasco County v. *New Eng. E. Ins. Co., supra.*

While it may be said that technically a surety can only be "subrogated" to the rights of creditors whom it pays, there are, nevertheless, certain rights which a surety may derive from the contractor as a consequence of legal precepts akin to those of subrogation. Judge (now Mr. Justice) Cardozo put it in this way in *Johnson Service* v. *Monin, supra:*

> "In thus holding the surety to the performance of its covenant, we do not leave it helpless, without means of reimbursement. What it pays to the municipality will be subject to a trust for the benefit of the Buckeye Blower Company (the materialman), and indeed for the avoidance of circuity may be paid to that company directly. In return it (the surety) will have the right to be subrogated in an equivalent amount to the right of its own principal, the general contractor, to collect from the municipality the balance due under the con-

tract. Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. ed. 547; Lacy v. Maryland Casualty Co. (C. C. A.) 32 F. (2d) 48. In the end, the materialman will have reimbursement from the surety, and the surety from the city. The loss will fall on the contractor who in equity should bear it."

The decision of this court in *Henningsen* v. *United States F. & G. Co., supra*, also takes the same approach. In that case there was a contest between the surety and an assignee bank for the retained percentage. This court held that the fund belonged to the surety by virtue of its right of subrogation. The court, in speaking of subrogation, however, failed to state to whose rights the surety was subrogated. The respondents urge that the court meant that the surety was subrogated to the rights of the creditor materialmen. No foundation whatever for this inference is to be found in the court's opinion. On the other hand, the head-note of the official report states: "In such a case the surety is subrogated to the rights of the contractor, but the bank is not." (208 U. S. 404).

We suggest that the term "subrogation" is there used in the same sense as it was used by Mr. Justice Cardozo, (and that is the sense in which it is hereafter used in this subdivision of the brief), when he spoke of the right of the surety "to be subrogated * * * to the right of its own principal, the general contractor, to collect from the municipality the balance due under the contract". (*Johnson Service Co.* v. *Monin, supra*). It therefore appears that even if the direct right which the surety has in or to the reserved fund be denied, the Surety, nevertheless, has a right to be "subrogated" to the rights of the contractor to collect the unpaid balance from the United States Government.

The respondents urge, however, that even if the Surety is "subrogated" to the rights of the contractor, it would

have no preferred right to the fund as against the claims of materialmen. The respondents admit that the Government may pay the money over to the contractor and that the contractor can spend the money as he sees fit. (Respondents' Brief, Circuit Court of Appeals, p. 19). If the Surety may be "subrogated" to this right of the contractor, it would seem that the contractor has a superior claim to the fund. It has been repeatedly held that a surety may be subrogated to the rights of the contractor even though there be general creditors of the contractor existent at that time.

Hardaway v. *National Surety Co., supra.*

Illinois Surety Co. v. *Mitchell,* 177 Ky. 367; 197 S. W. 844 (1917).

First National Bank v. *Pesha,* 99 Neb. 785; 157 N. W. 924 (1916).

Hackensack Brick Co. v. *Borough of Bogota,* 86 N. J. Eq. 143; 97 Atl. 725 (1916).

Johnson Service Co. v. *Monin, supra.*

Crown Lumber Co., Ltd. v. *Smythe,* [1923] 3 D. L. R. 33.

It is asserted, however, that the materialmen are entitled to different treatment from that accorded the contractor's general creditors; that there is some transcendent equity existing in their favor. It is difficult to discover just why materialmen's rights are so sacrosanct as compared to the rights of other general creditors.

No question as to the relative equities of the materialmen on the one hand and the contractor on the other to the fund arises in a determination of the surety's right to be "subrogated" to the contractor's claim to the fund. The equities should be balanced as between the surety and the materialmen, and not as between the contractor and materialmen. It will be pointed out (Point II, p. 44, *infra*) *that* the equities of the situation distinctly preponderate in the Surety's favor.

The petitioner submits that if this court follows the reasoning of the *Henningsen* case and of *Johnson Service Co. v. Monin, supra,* the fund in court will be turned over to the Surety. The principles announced in those cases inevitably lead to that end.

Another line of cases which is very analagous to the instant situation and which strongly suggests its correct disposition is that group of cases which holds that where the surety completes the contract of the defaulting contractor, the surety is subrogated to the rights of the governmental agency.

Prairie State Bank v. *United States, supra*
Maryland Casualty Co. v. *Board of Water Commissioners,* 66 Fed. (2d) 730 (C. C. A. 2d 1933)
Lacy v. *Maryland Cas. Co., supra*
First National Bank v. *City Trust, etc. Co.,* 114 Fed. 529 (C. C. A. 9th 1902)
State ex rel Southern Surety Co. v. Schlesinger, 114 Oh. Stat. 323, 151 N. E. 177 (1925)
United States Revised Statutes, Sec. 3468, Comp. Stat. Sec. 6374, Sec. 193 of Title 31, U. S. C. A.

The fact that there are unpaid laborers and materialmen does not destroy the surety's right to be subrogated to the rights of the state where the surety has completed the contract.

Union Stone Co. v. *Hudson County,* 71 N. J. Eq. 657, 65 Atl. 466 (1906)
St. Peter's Catholic Church v. *Vannote,* 66 N. J. Eq. 78, 56 Atl. 1037 (1904)
Tuttle v. *School District,* 62 Ia. 422, 17 N. W. 603 (1883)

These cases all hold that where the surety has completed the contract of its principal that the surety thereby receives

by way of subrogation whatever rights the state had in the premises. That is the settled law of the Federal courts.

Prairie State Bank v. *United States, supra*
Maryland Cas. C. v. *Bd. of Water Comm., supra*
Lacy v. *Maryland Cas. Co., supra.*
National Surety Co. v. *County Board,* 15 Fed. (2d) 993 (C. C. A. 4th, 1926)

As a matter of substantive law it is difficult to see why it is that the surety should be given a right of subrogation to the state's rights where it actually completes the contract and should not have that right where the surety provides for the completion of the contract. Is there any substantial or real ground for allowing the surety relief where it does the work directly and denying the surety this right where it pays for the work that has been done, or where it has served as the impetus for the work that was done? Regardless of whether the surety does the work or whether it pays for it, the final result is essentially the same—the surety is out of pocket in both cases, the governmental unit receives the benefit of the surety's work or bond in either case, and if the surety receives the retained fund, there may be unpaid materialmen in either situation. To pose the issue concretely, if the Contractor had defaulted in the present case and if the Surety Company had expended $3940 for labor and materials, there would be no doubt that the Surety would be entitled to the reserved fund. What material difference in law can it make that the Surety has paid out $3940 to materialmen for work that they have already done instead of making actual purchases and payments for materials? An attempt to make a differentiation between the surety which takes over the contract and actually completes the project and the surety which furnishes the money which is used to pay those who furnished materials yesterday seems highly arbitrary.

It may be urged that the present Surety has not relieved the Government from any obligation or that it has done nothing for the Government which entitles it to be "subrogated" to the rights of the Government. True, in the strict sense of the word, the Surety has not done anything that would give it any rights under conventional subrogation, but it is submitted that certain principles of equity which are closely related to those applicable in the law of subrogation and which have been applied by the courts in numerous cases decree that sureties circumstanced similarly to the present petitioner recover the reserved fund.

Further it is not accurate to say that the present Surety has done nothing for the Government. The Government has benefited from the bond in a number of ways. The Government has received everything that it contracted for under the bond—this was made possible in no small degree because the Surety's undertaking was the prime assurance to the Government that the contract would be completed.

It almost goes without saying that the accrual of such a benefit to the Government should constitute sufficient ground for granting the surety a remedy that is very similar to that of subrogation. A decision to that effect would be in conformity with the holding of this court in the Prairie State Bank case.

Doubtless the respondents will recognize the merit of this assertion and attempt to fall back on the general rule of law that a surety cannot be subrogated against his creditor. That is undoubtedly the weight of authority in this country. There is, however, respectable authority to the contrary.

In re American Products Co., 224 Fed. 401, (Appeal dismissed 239 U. S. 637; 50 L. Ed. 480).

Contra: *United States* v. *National Surety Co.*, 254, U. S. 73; 65 L. Ed. 143 (1920).

Olsness v. *Baird*, 52 N. D. 1, 201 N. W. 993 (1924).

The petitioner will not undertake to deny or debate this question since it is not considered to be applicable or controlling in the case at bar. Mr. Justice Brandeis (at page 76) has stated the rule to be as follows:

> "• • • This result is in harmony with a familiar rule of the law of subrogation under which a surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt, or it is otherwise satisfied." (*U. S.* v. *National Surety Co., supra.*)

In the present case the Surety is not asking that it be subrogated "to collateral or remedies available to the creditor." The Surety makes no claim to the fund through the materialmen—no effort is made to be subrogated to any possible rights of the materialmen. Indeed, it is the Surety's position that the materialmen have no claim to the fund (Point II, p. 31, *infra*). The Surety contends that it is "subrogated" to the rights of the contractor or of the Government, or both.

The Surety therefore is not demanding that it be "subrogated" to the rights of a creditor who has not been paid in full, but rather says that it is "subrogated" to the rights of the contractor or the Government.

The argument was also advanced below that the Surety had not fulfilled its obligations under the bond. It is said that since the bond provides that payment be made "to all persons supplying the principal with labor and materials" (R. 20), that payment of the full penalty of the bond does not extinguish the suretyship obligation. Just what type of duty or obligation the Surety has to materialmen after it has paid the full amount of the bond is not disclosed. The respondents attempt to make the bond a blanket undertaking, but at the same time they are forced to admit that it has certain limitations. It is indeed a strange obli-

gation that cannot be extinguished even by payment in full. Just how far this super-imposed duty goes is not divulged.

It is interesting to note, however, that the bond only stipulates that payment be made "to all persons." It does not state that the contractor shall make payment "to all persons" *in full*. When this fact is considered along with the complete lack of any promise whatever on the part of the contractor in either the contract or bond to pay materialmen in any amount and that even though a larger bond could have been demanded, it was, nevertheless, expressly limited to $3940 by the contracting parties, it may well be doubted that it was ever the intent of the parties that such broad language should be read into the bond.

In support of their position the respondents relied on the case of *Maryland Casualty Co.* v. *Fouts, supra.* In that case, however, the bond was expressly conditioned that "all moneys" belonging to the obligee should be repaid in full. These suggestions may appear to be somewhat technical, but we submit that they are sound. It is only by the most technical and labored reasoning that respondents argued that the present Surety's obligation was not terminated when it paid the full penalty of the bond.

The court had presented to it a situation in *In re American Products Co., supra,* which is almost identical to the one involved in the instant proceeding. In that case there was a contest between the surety and the unpaid materialmen for the retained percentage. The surety had paid the full amount of its bond, and this money was distributed ratably among the creditors—each receiving about 50% of his claim. The contractor had been adjudged bankrupt. The court held that the surety was entitled to prove the amount of such payments against the bankrupt's estate. It is true that this bond was given in compliance with certain municipal ordinances, but it does not appear that they were in any

essential way different from the Federal Statute. The court said (p. 403):

> "And it is also true that at the date of the bankruptcy the Surety Company had paid all it was bound to pay, and had become in equity the creditor of the Product Company to the full amount of the bond. It had never undertaken to pay all the debts of the Product Company; its promise was to pay them up to the limit of the penal sum, and, having discharged that obligation it was bound no further to those creditors, either legally or equitably. In our opinion, the argument in support of the decree goes astray just at this point. The position of counsel is based on the evident assumption that the Surety Company is still under some obligation to these creditors, and therefore cannot be allowed to share in the fund until the creditors themselves have been paid in full. But we do not so understand the facts. In substance the situation is this: The Surety Company agreed to pay as much of these debts as could be discharged with $34,395, and it met this obligation faithfully. * * *"

We submit, however, that it is immaterial as to whether the petitioner has fully discharged its obligation to the materialmen. As heretofore stated, petitioner makes no claim to the rights, if any, of the materialmen, but urges that by reason of certain legal principles, which are closely akin to subrogation, it is "subrogated" either to the rights of the contractor or the Government. The surety has fulfilled all of its covenants to both of these parties and is, therefore, entitled to be "subrogated" to their rights.

But, even if the Surety has no right of subrogation, the absence of such right in no manner affects its direct right to the fund by virtue of the relationship of the parties and as an incident of its contract of indemnity as has been shown previously (Point .I, p. 6, *supra*). Nor is that right conditioned upon the Surety's full discharge of all obligations under its bond.

(C).

PAYMENT OF THE RETAINED FUND TO THE MATERIALMEN WOULD CONSTITUTE AN IMPAIRMENT OF THE SURETY'S RIGHTS UNDER THE ORIGINAL CONTRACT.

Thus far the petitioner has shown that it has a right to the reserved fund which is superior to that of the materialmen. This reserved fund was set aside by the terms of the original contract between the Surety and the contractor as a trust fund or security out of which the Surety was to be reimbursed for all deficiencies under the contract. The fund was definitely marked for that purpose. The respondents now seek to divert the fund from that channel—this Court is now asked to apply the ear-marked property in such a way as utterly to defeat all interest that the Surety has in the fund. This ought not to be done. The rights of the petitioner in the security may not be impaired.

Prairie State Bank v. *United States*, *supra*.

Justice v. *Empire State Surety Co.*, 209 Fed. 105 (D. C. E. D. Pa. 1913).

O'Neill v. *Title Guaranty & Trust Co.*, 191 Fed. 570 (C. C. A. 6th, 1911).

All of these cases support the proposition that a surety's interest in the security given for its protection must be respected. An impairment of such security releases the surety from its undertaking. Mr. Justice White gave very careful consideration to this question in the Prairie case. Attempts have been made to make it appear that the Prairie case was decided solely on the ground that since the surety completed the defaulting contractor's contract that it was subrogated to the rights of the Government and was entitled to the fund. It is, therefore, said that the Prairie case is inapplicable in our immediate situation. There might be some weight in the respondents' suggestion if the last half of Mr. Justice

White's opinion could be disregarded. In that portion of the opinion it is clearly shown that the court did not decide the case wholly on the theory of subrogation, but also decided that since the surety had an equity in the reserve fund, any diversion of that fund would impair its rights and relieve the surety. The court refused to allow the fund to be diverted from the surety. It is equally significant that the court did not consider this right of the surety in the fund to arise because the surety had completed the contractor's contract. The court held that this right was created by the original contract just as it was in the case at bar. The court said (164 U. S. pp. 239, 240):

> "Applying the principles which are so clearly settled by the foregoing authorities to the case at bar, it is manifest that if the transaction in February, 1890, by which the Prairie Bank acquired its alleged lien on the fund possessed the effect contended for by the bank, it would necessarily operate to alter and impair rights acquired by the surety *under the original contract.*" (Italics ours.)

Nor should it be overlooked that the contract of indemnity was offered and submitted to the Surety by the contractor along with its original application for the bond. This contract was a part of the original contract. The agreement was a substantial part of the consideration which induced the Surety to execute the bond; it tended to lessen the risk and consequently decreased the amount of the premium charged for the bond. All of these factors entered into the original negotiations and were undoubtedly powerful influences in bringing about the execution of the bond. If the Surety is now to be stripped of the benefit which this contract conferred upon it, there will be a failure of a substantial part of the consideration given for the bond. This result should be avoided.

The petitioner submits that it is entitled to the reserved fund since it has a direct right to the fund, since it has a right to be "subrogated" to the rights of either the contractor or the United States Government, and since a failure to apply this fund to the ends designated by the contract between the Surety and the contractor would bring about an impairment of the petitioner's rights and since it would result in a failure of consideration.

Point II.

The Materialmen Have Only a General Creditor's Claim to the Reserved Fund.

(A).

The Materialmen Have no Equitable Lien on the Fund.

Some general observations have already been made concerning the nature and attributes of equitable liens (Point I, p. 18, *supra*). Equitable liens may be created by express contract or they may be implied where equity and good conscience justify their creation. However, the courts do not recognize every moral or equitable obligation as warranting the implication of an equitable lien. There are settled rules of law which guide the courts in dealing with this somewhat intangible and nebulous right—the courts do not use this power as a "roving commission" to reform and protect *sui juris* individuals against their own errors and shortcomings. Thus in our present case it is incumbent upon the materialmen to advance some justification based upon concrete principles of law or fact and not upon empty generalities which will sustain the imposition of an equitable lien upon the fund now in court. The materialmen must show that their alleged equitable lien is created either by some statute or by an express contract, or that in compliance with established principles of law an equitable lien exists.

1. *No express contract gives materialmen an equitable lien on the fund in question.*

Admittedly, the materialmen have no equitable lien by reason of any express contract. There is no agreement that would give the slightest color or comfort to the respondents in this respect. Indeed, the majority opinion of the Court of Appeals concedes that without the aid of a statute, laborers and materialmen are simply general creditors of a contractor. Judge Walker, speaking for the majority in the Court of Appeals, said (R. 82):

> "• • • In the absence of a statute on the subject, furnishers of labor or material to a contractor have the legal status of general creditors. • • •"

2. *The materialmen have no equitable lien by reason of any statute or statutes.*

The common law afforded materialmen no special relief against the property improved or against the reserved fund, unless there be some special contract provision creating such a right. While the Roman law was otherwise, the English law did not recognize or enforce such rights. The American decisions are in accord with the English common law.

Van Stone v. *Stillwell & Bierce Mfg. Co.*, 142 U. S. 128, 35 L. Ed. 961 (1891).

South Fork Canal Co. v. *Gordon*, 6 Wall 561, 571, 18 Law Ed. 894 (186[redacted]

In re Fowble, 213 ed[redacted]6 (D. C. Md., 1914).

Prince v. *Neal-Millard Co.*, 124 Ga. 884; 53 S. E. 761.

See *Dillon, Municipal Corporations*, Vol. 2, Sec. 830 (5th Ed., 1911).

Jones on Liens, Vol. 1, Sec. 53 (3rd Ed., 1914).

Nor does the insolvency of the debtor contractor change the status of the materialmen.

Withrow Lumber Co. v. *Glasgow Investment Co.*, 101 Fed. 863 (C. C. A. 4th, 1900).

Does any controlling statute or statutes give the present materialmen an equitable lien on the funds which are now in court? The majority of the Court of Appeals accepted the argument made by the respondents that the Act of August 13, 1894, and its amendments, (Chap. 280, 28 Stat. 278; Feb. 24, 1905, Chap. 778, 33 Stat. 811; Mar. 3, 1911, Chap. 231, Sec. 291, 36 Stat. 1167; 40 U. S. C. A., Sec. 270), gave materialmen a lien on the reserved fund in addition to the rights which they have by the statutory bond. There is nothing in the terms of the statute itself which justifies this inference. Notwithstanding, the court in some way found that although materialmen did not possess this right before the statute was enacted, the materialmen did have such a right after its enactment. The reasoning by which the court arrives at this conclusion is, we submit, unsatisfactory and unsound. The court said (p. 82):

> "• • • In the absence of a statute on the subject furnishers of labor or material to a contractor have the legal status of general creditors. Before the enactment of any Federal statute on the subject, it was not unusual for the Government to recognize the existence of a moral duty to protect furnishers of labor or material for a public work against dishonest or reckless contractors by requiring the insertion in a contract for such work of a provision requiring payment by the contractor of amounts owing by him to furnishers of labor or material for the work contracted for, or entitling the Government to withhold payments to the contractor if he failed to pay promptly those who furnished labor and materials. Greenville Sav. Bank *v.* Lawrence, 76 Fed. 545. It appears from decisions referred to below

> that the Government's observance of that duty in practical and effective ways was the precursor of judicial recognition of an enforceable equitable right of unpaid furnishers of labor or materials for that work in or to a part of the contract price thereof remaining in the possession of the Government after the completion of that work by the contractor. Nothing contained in the statute in pursuance of which the bond on which appellant was surety was executed is inconsistent with the Government's recognition of the continued existence of a duty to protect furnishers of labor or material, with the result of making such furnishers beneficiaries of the funds withheld by the Government. • • •"

The court first states that laborers and materialmen have no lien in the absence of a statute creating such a right. The court then speaks of a moral obligation on the part of the Government to see that materialmen are paid and that this obligation was recognized before the enactment of a Federal statute *when the contract provided that such be done.* The recognition of that duty by the Government, the court says, was the "precursor of judicial recognition of an enforceable equitable right" in unpaid materialmen to the funds withheld by the Government. It is then said that "nothing contained in the statute in pursuance of which the bond • • • was executed is inconsistent with the Government's recognition of the continued existence of a duty to protect furnishers of labor and materials, with the result of making such furnishers beneficiaries of the funds withheld by the Government". But where has the Court shown that the statute created the equitable lien? Indeed, it would seem that the statement of the court that "in the absence of a statute" materialmen have no preferred status and the court's statement that nothing in the statute is "inconsistent with the Government's recognition of the continued existence of a duty" to protect materialmen are contradictory. We respectfully submit that the majority opin-

ion in no way explains or shows how or in what way the Act of August 13, 1894, as amended, establishes an equitable lien on the retained percentage.

The majority opinion goes on to say that the case of *Henningsen* v. *United States F. & G. Co., supra,* supports their conclusion that after the Act of 1894 materialmen have an equitable lien on funds held back. This assumption is based upon the following language from the Henningsen case:

> "• • • It (the surety) paid the laborers and materialmen, and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that laborers and supply men were paid. • • •"

There is nothing in this statement which indicates that the so-called "equitable obligation" on the part of the Government to see that materialmen are paid created an equitable lien on retained funds. The words "equitable lien" are not to be found in the court's opinion. There is not the slightest intimation in the decision that materialmen have such a right. The petitioner urges that whatever "equitable obligation" the Government has is incorporated in the surety bond. When a bond is given in accordance with the statute and its penalty is fixed at such amount as the Government believes adequate to protect the materialmen, and that sum is paid in full by the surety, the Government has discharged whatever "equitable obligation" it ever had to see that materialmen are paid. This suggestion is entirely consistent with both the language and result of the Henningsen case. If the Government has some greater obligation than this, why was not provision made for it in the Act of 1894 or in the subsequent amendments thereto? The terms of the statute are themselves silent refutations of the respondent's position.

If the Government has an equitable obligation that transcends even the bond, it is timely to inquire as to the limitations of this obligation. We may well speculate as to where this argument will lead. What would be the Government's obligation if both the bond and reserved fund failed to pay materialmen in full? If the respondents are correct, the Government still has not extinguished its equitable obligation to the materialmen. Will the materialmen then have a claim against the Government? The law is settled beyond doubt that the Government may ignore the claims of materialmen with impunity even though the contract authorizes the Government to make payment of the reserved fund to the materialmen. The courts deny materialmen any relief against the Government in such a situation.

Dupont, etc. Co. v. *City of Glenwood Springs*, 19 Fed. (2d) 225 (C. C. A. 8th 1927).

In re Fowble, supra

Columbia Brick Co. v. *District of Columbia*, 1 App. D. C. 351 (1893).

Much emphasis was also placed in the majority opinion of the Court of Appeals and by the respondents upon the interpretation given the Henningsen case by the court in *Belknap Hardware Co.* v. *Ohio River Contract Co.* (271 Fed. 144; C. C. A. 6th 1921). In that case the contest was between the unpaid materialmen and the contractor's general creditors. The Belknap case only decides that as between materialmen and general creditors of the contractor the materialmen have a superior right to the retained funds. The court expressly limited its opinion to that issue. Judge Denison said (p. 149):

> "If this is the true principle of the decision, it may not be clear what the rights of the parties would be in the various situations that might arise, e. g., as between a surety who had performed the contract and claimants

> of this class unpaid when the surety took it over, *or as between a surety who had paid claims of this class to the limit of his bond and the unpaid remainder of the same class; but those questions can be met when they arise.* * * *" (Italics ours.)

It follows that what was said by the court in the Belknap case with respect to the Henningsen case is not controlling in the case at bar. However, if the Belknap case can be considered in the present case, it is clear that the force of that decision must depend upon whether the court correctly interpreted the holding of this court in the Henningsen case. Since it has been shown, we submit, that nothing in the Henningsen case creates an equitable lien for materialmen, necessarily the interpretation given the Henningsen case by the court in the Belknap case is unwarranted. Indeed, the court indicated in the Belknap case that, if it did not feel bound by the Henningsen case, as construed, its decision might have been otherwise.

Judge Denison also recognized that an equitable lien on behalf of materialmen must come from some statute or contract. He states (p. 147):

> "* * * It is commonly held that this lien or priority is wholly statutory and we are not aware of any case (unless those hereafter discussed) where, without the aid of any contract or statute, this vague equity of materialmen and laborers has been thought sufficient to put the owner of the property under obligation to see that they were paid before he settled with the contractor."

If it is the law that materialmen's equitable lien must be founded on some statute, in the absence of a contractual lien, it seems strange that no court has found any provision in the Act of 1894, or any other statute, which has that effect. No satisfactory explanation was adduced in the Bel-

knap case or in the majority opinion of the Court of Appeals in the instant case or in any other case cited below by the respondents. Judge Sibley aptly said that "I see no basis for one (equitable lien) without judicial legislation." (R. 85.)

The case of *Alfred Richards Brick Co.* v. *Rothwell*, 18 App. D. C. 516 (1901) is sometimes cited as holding that the Act of 1894 establishes an equitable lien on reserved funds? While there is some language in that case which supports such a supposition, none of it was necessary to a decision of the issues in the case and was pure *dicta*. There the contest for the reserved fund was between the general creditors of the contractor and its surety. The rights of materialmen were not involved.

An examination of the Congressional debates and its committees' hearings and reports fails to reveal any intent on the part of Congress to give laborers or materialmen a preferred status as to reserved funds. The statute sets up a machinery which purports to grant laborers and materialmen adequate protection. It cannot be denied that this statute supplies the means by which laborers and materialmen may be paid in full. The mere fact that the statute may, in certain cases, be administered inefficiently or that the contractor may be incompetent or wasteful affords no ground for the assumption that Congress intended in such cases that unpaid materialmen should have an equitable lien on funds due the contractor. The statute provides that a bond be given which is conditioned for the prompt payment of all persons supplying labor and materials. It does not follow that in cases where it turns out that the penal sum is insufficient to pay all such claimants in full that materialmen are given further and greater rights under the terms of the Act.

A study of the statute itself defeats any such conclusion. The statute provides: (40 U. S. C. A. Sec. 270):

> "* * * If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder (of the bond) shall be distributed pro rata among said interveners. * * * If the recovery on the bond should be inadequate to pay the amounts found due to all of said crediors, judgment shall be given to each creditor pro rata of the amount of the recovery. * * *"

These two provisions of the statute expressly show that Congress contemplated that situations would arise under the statute where the penalty of the bond would be insufficient to meet the claims of laborers and materialmen in full. If it was the purpose of Congress to give laborers and materialmen further protection, it would seem that the statute would have so provided. Further, congressional acquiesence in this language over a long period of time indicates that the statute was intended to give laborers and materialmen only such relief as is specifically provided for by it.

It is striking that, although the last session of Congress passed a law which supercedes and revises the previous statutes as to contractors' bonds and the rights of laborers and materialmen thereon, no attempt was made in the new statute to give materialmen a right to retained percentages. Nothing can be found in the new act which indicates that it ever was or is now the intent of the Congress to give materialmen a lien on reserved funds. (Public No. 321 74th Congress H. R. 8519, App. Aug. 24, 1935.) The failure of Congress to change the old statute in this respect clearly indicates that the Congress does not wish such a change.

Likewise the maxim *expressio unius est exclusio alterius* precludes the interpolation of any such meaning into the

statute. This is a settled rule of statutory construction and definitely prevents reading into the statute anything which its language does not import or comprehend.

We also know that it was the purpose of this statute to act as a substitute for the lien which the materialmen would ordinarily have if the contract did not involve public property. This statute was intended to give materialmen a type of security which would protect them and which would at the same time secure the Government of expeditious performance. It was not the purpose of the statute to create a lien on the funds of the contractor that might be in the hands of the Government and which might lead to troublesome litigation if such funds were diverted by the Government.

Equitable Surety Co. v. *United States*, 234 U. S. 448; 58 L. Ed. 1394 (1914);
Hill v. *American Surety Co.*, 200 U. S. 197, 203; 50 L. Ed. 437, 440 (1906);
United States F. & G. Co. v. *United States*, 191 U. S. 416; 48 L. Ed. 242 (1903).

The courts have frequently held that the Act of 1894 and similar state statutes do not create an equitable lien in favor of materialmen on reserved funds.

American Surety Co. v. *Finletter, supra;*
Freeny v. *Bauernschmidt*, 33 F. (2nd) 709 (C. C. A. 4th, 1929);
Pratt Lumber Co. v. *T. H. Gill Co., supra;*
In re Fowble, supra;
Kellas v. *Slack*, 129 Md. 535; 99 Atl. 677 (1916);
Sexauer & Lemke v. *Burke & Sons Co.*, 228 N. Y. 341; 127 N. E. 329 (1920);
Robinson Mfg. Co. v. *Blaylock, supra;*
Southern Surety Co. v. *Schlesniger, supra;*
See: *Hardaway* v. *National Surety Co., supra.*

The court had before it a case very similar to the present one in *In re Fowble, supra.* There the unpaid materialmen and the surety were competing for the balance of the contract price. The bond was given pursuant to a Maryland statute which is substantially the same as the Federal statute. There was no express provision in the bond requiring the contractor to pay materialmen. In like manner there is no promise on the part of the contractor in the case at bar to pay materialmen. The court held that the materialmen had no equitable lien on the reserved fund and were only entitled to claim as general creditors. In the course of his opinion Judge Rose said (p. 681):

> "The materialmen contend that in any event they had an equity in the fund superior to that of the trustee. Most men feel that one who has contributed to the creation of anything of value stands in a peculiar relation to it. He has a special claim to be paid out of it. The mechanic and other lien laws of so many jurisdictions are the expression of that conviction. The courts, however, have not seen their way clear to make it a generally applicable principle of equitable jurisprudence. It has had its part in shaping many a rule administered in chancery, but complete recognition has been withheld from it. The difficulty, in many, if not in most cases the impossibility, of accurately and justly defining its limits have amply justified the hesitation of the courts. If mechanic's lien laws prove the strength of its appeal to an instinctive sense of natural justice, they demonstrate that it is usually impossible to apply it beyond the limits to which the statutes go."

(3) *There is no basic reason for implying an equitable lien on the retained funds.*

The only remaining ground by which the respondents can contend that they have an equitable lien is that one should be implied. That equitable liens may arise *ex aequo*

et bono is not denied, but it by no means follows that the courts will apply this formula wherever it appears that as between two innocent parties one must suffer. In all cases where it is sought to invoke this doctrine of constructive liens, the courts weigh with meticulous care the equities of the respective claimants. Implied equitable liens are governed by fixed rules of law which must be respected and followed. Resort to the field of implication is at best a dangerous approach—such an approach usually presages a fundamental legal weakness in the case that can only be circumvented by invocation of this doctrine. It is not an "open sesame" or panacea for an otherwise insupportable cause of action.

There is no basis for implying an equitable lien on the reserved fund in the instant case. The contract between the Government and the contractor contains nothing which should cause an equitable lien to be implied. The contract does not state that the funds were to be retained for the benefit of materialmen or laborers. The contract negatives such a thought. The contract provides (R. 17):

> "In making such partial payments there shall be retained 10 per cent on the estimated amount until final completion and acceptance of all work covered by the contract: Provided, however, That the contracting officer, at any time after 50 per cent of the work has been completed, if he finds that satisfactory progress is being made, may make any of the remaining partial payments in full: And provided further, That on completion and acceptance of each separate building, vessel, public work, or other division of the contract, on which the price is stated separately in the contract, payment may be made in full, including retained percentages thereon, less authorized deductions."

This language conclusively shows that the funds were only to be retained "until final completion and acceptance"

of the project. The contract also states that when 50% of the work has been satisfactorily completed, the remaining payments may be made in full. If it had been the intent of the contracting parties that this fund be used to pay materialmen, the contract would not have provided that the funds be paid over to the contractor upon *completion* and *acceptance* of the work. This provision patently repudiates any inference that this fund was reserved to safeguard materialmen's claims.

The petitioner submits that when the language of the contract is considered there is no support for the statement that an equitable lien may be implied from the circumstances surrounding the contract between the contractor and the Government. Judge Sibley correctly analyzed the problem in his dissenting opinion when he said (R. 87):

> "* * * The only way to arrive at a lien for the materialmen that I can see is to assume that money retained by requirement of the contract is for the security of them also. This has not yet been authoritatively held, and because of the number of laborers and materialmen might prove embarrassing to Government in settling up contracts. The contract ought clearly to indicate such a purpose. The present contract does not. It contains no requirement that suppliers of labor and material be paid. The only reference in the contract to paying them is a provision that additional security on the bond protecting them can be required if the surety furnished should become unacceptable. The contract, like the statute, contemplates only the bond to secure them. The bond, of course, is conditioned to be void if the contractor fully performs the contract and in addition pays promptly all persons supplying labor and materials. If the contractor fails to pay any of them the surety must pay up to the penalty of his bond, but that is all. This it has done, and the bond and all its obligations are satisfied. * * *"

The opinion of the court in *In re Scofield*, 215 Fed. 45 (C. C. A. 2d, 1914) is also very helpful. The court said (p. 48):

> "There is nothing in this record to indicate that the United States withheld the reserved percentages for the benefit of the subcontractors, unless such intention can be inferred from the language of the bond, which made it the duty of the contractor to pay promptly the subcontractors. The contract itself, in providing for withholding the percentages, does not state or explain the reason, at least so far as this record shows. It simply states that they may be withheld 'until the final completion and acceptance of the work'. This might seem to indicate that the purpose was simply to secure the government in case the work was not prosecuted promptly and faithfully, for the contract expressly provided that if for any of the reasons stated in the contract the United States found it necessary to terminate the contract, then it might deduct from the reserved percentages which it had withheld whatever sums it expended in completing the contract in excess of the stipulated price, and it allowed certain other deductions to be made. And there was no authority given to pay any subcontractors or deduct from the reserved fund any sums paid to any such persons. Nevertheless when the contract is construed in its entirety and in connection with the obligations imposed by the bond, it will be found that an equity was created in favor of the surety in the reserved fund to which it is the duty of this court to give effect."

Pretermitting the contract, there is no essential equity in the materialmen which would demand that an equitable lien be appended to the reserved fund. It seems peculiar that if the materialmen placed as much reliance on the reserved fund in making their respective sales to the contractor as they now assert, that they did not take the proper

steps to make certain that this fund would be used for their benefit. It was perfectly competent for the materialmen to contract with the Surety and the contractor for such a lien, or to decline to furnish in the absence of such security. The Surety took proper steps to insure itself that it would have the protection of this fund. We respectfully suggest that this Surety should not be penalized because it chose by legitimate means to safeguard itself from loss. Nor should a court of equity be more zealous to create or protect materialmen's rights than were the materialmen themselves.

It is reasonable to conclude that in dealing with the contractor the materialmen relied wholly upon the penalty of the bond and the contractor's financial stability. Furthermore, the respondents had notice of the Surety's rights in the fund before they extended any credit to the contractor. That notice may have been actual or constructive. The bond was required by statute. The respondents cannot claim ignorance of the law. The materialmen were thereby put on notice that there was a surety and were therefore bound to inquire as to the terms of the suretyship relation. Such inquiry would have disclosed that the surety was bound to pay laborers and materialmen to the extent of $3940; that a certain percentage of the contract price was reserved; and that the surety had an interest in all unpaid moneys owing the contractor.

The materialmen should have the same notice of the surety's relationship as have assignee banks. In one case the transaction takes place solely between the contractor and materialmen, and in the other between the contractor and the bank. No principle of law or equity says that materialmen may exercise less care and caution in dealing with the contractor than is required of an assignee bank. Nor does any rule of law guarantee that if materialmen take no steps to protect themselves in such dealings an

equitable lien will arise to protect them. The courts have ofttimes held that an assignee bank has no superior right to the reserved fund as against a surety for the reason, among others, that the bank has notice of the surety's rights in the fund.

New Amsterdam Casualty Co. v. *City of Astoria, supra;*

American Bank & Trust Co. v. *Langston,* 180 Ark. 643; 22 S. W. (2d) 381 (1929);

Wasco County v. *New England E. Ins. Co., supra;*

Derby v. *United States F. & G. Co.,* 87 Oreg. 34; 169 Pac. 500 (1917).

In *New Amsterdam Casualty Co.* v. *City of Astoria, supra,* the court said (p. 563):

> "'• • • the contracts being for the prosecuting of public work, persons taking assignments from the contractor of funds to be disbursed in final payments are bound to take notice, first, of the terms of the contract; second, that the contract is accompanied by the bond of a surety, and likewise of the undertaking of the surety; and, third, that the reserve fund is for the indemnity of the surety as well as that of the city. This subordinates the claims of the assignees of parts of the funds to become due to the demands of the surety."

When all of these factors are taken into account, we may well question the soundness of the suggestion that this court should create a lien purely on the basis of implication. This court is now asked to upset or ignore certain rights which have been purchased by the Surety for a valid consideration. These rights were not obtained fraudulently or by means of an act of bankruptcy—they were acquired legitimately. We submit that there are no circumstances

in the case which should cause a court of equity to imply an equitable lien on behalf of materialmen.

Finally, it should be observed that even if an equitable lien were implied in favor of the materialmen, the equitable lien which the petitioner has on the fund is superior and should take precedence since it arises from an express contract and since it was prior in time. The equitable lien of the materialmen, if there be such, can only be the product of implication or, as Judge Sibley said, of "judicial legislation." If there be any fallacy in a law which fails to give the materialmen complete protection in every case, the error is one which should be corrected by the Congress and not by the courts. The materialmen can also safeguard themselves if they so desire by making appropriate contracts for that purpose.

(4) *A discretionary retention of funds does not establish an equitable lien for the materialmen on such funds.*

A discretionary power to retain a part of the contract price creates no equitable lien on the funds retained. If an equitable lien is to be settled upon a reserved fund, the right to withhold such a fund must be absolute.

Kane, Trustee v. *First National Bank*, 56 Fed. (2nd) 534 (C. C. A. 5th, 1932).

Alfred Richards Brick Co. v. *Rothwell, supra.*

In the case at bar the contract between the Government and the contractor provides that 10% of the contract price may be held back pending "final completion and acceptance" of the project. The project was completed and accepted long before the funds in question were paid into court. The retention of those funds by the Government after the completion and acceptance of the work was not authorized by the contract. The best that can be said for this conduct is that the Government had a discretionary right to hold back those

funds. This discretionary retention created no equitable lien for the materialmen on the funds.

The respondents may reply that their equitable lien, assuming that they have one, had attached to the funds prior to the completion of the contract. Even if this be true, that lien was lost when the absolute right on the part of the Government to retain those funds terminated. The materialmen's lien, if any, must be co-extensive with the unrestricted power of the Government to keep back those funds. They certainly have no greater right.

However, if it be assumed that they have a right which was affixed to the funds prior to the completion of the contract, the materialmen would have no lien on the entire $2,775.25 now in court. They can only have an equitable lien, if at all, on $762 of that amount. Since 10% of the contract price is $1,524, and since the Government only had an unqualified right to withhold 10% of the estimates until 50% of the work was satisfactorily completed, it would follow that the Government, under the terms of the contract, had an absolute right to retain only 50% of $1,524 or $762. All other funds which were retained were based on the Government's discretionary power and can constitute no foundation for an equitable lien (Judge Sibley's dissenting opinion, R. 88).

Point III.

If the Surety is Denied a Preferred Claim, It, Nevertheless, Has a General Creditors Claim and Would Share Ratably With the Materialmen and Other General Creditors.

If this Court should be of the opinion that the Surety has no prior equity in the fund, the Surety is certainly entitled to participate *pro rata* with the materialmen and other general creditors in the distribution of the present fund. It has been previously shown that the materialmen are only general creditors of the contractor. (Point II, p. 31, *supra*).

The decision of the Court of Appeals giving materialmen priority over the Surety is not consistent with the great weight of authority.

Mellette Farmers El. Co. v. *H. Poehler Co.*, *supra.*

United States F. & G. Co. v. *Centropolis Bank*, *supra.*

In re McGarry & Son, 240 Fed. 400 (C. C. A. 7th, 1917).

Southern Surety Co. v. *Merchants & Farmers Bank*, 203 Ind. 173, 195, 176 N. E. 846 (1931).

Cole v. *Myers*, 100 Nebr. 480; 160 N. W. 894 (1916).

In view of these authorities it is clear, we submit, that the Court of Appeals was in error in completely subordinating the rights of the Surety to those of the materialmen.

Conclusion.

Since it has been shown that the Surety has a direct right to the fund; that it has a claim to the fund on principles analagous to those of subrogation; that the materialmen have no equitable lien on or preferred claim to the fund, it is submitted that the Surety is entitled to the entire amount of the reserved fund.

Respectfully submitted,

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APPENDIX.

The Statute Involved.

Title 40, Sec. 270, of United States Code Annotated.

§ 270. Bonds of contractors for public buildings or works; rights of persons furnishing labor and materials. Any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required. before commencing such wark, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and materials shall, upon application therefor, and furnishing affidavit to the department under the direction of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond,

upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and execution: *Provided*, That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later: *And provided further*, That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *Provided further*, That in all suits instituted under the provisions of this section such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors, and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor. (Aug. 13, 1894, c. 280, 28 Stat. 278; Feb. 24, 1905, c. 778, 33 Stat. 811; Mar. 3, 1911, c. 231, § 291, 36 Stat. 1167.)

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CHARLES ELMORE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. [redacted]9 12

AMERICAN SURETY COMPANY OF NEW YORK,
a corporation,

Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING
COMPANY, a corporation, et al.,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

WILLIAM FISHER,
Counsel for Respondents.

W. H. WATSON,
S. PASCO,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 819

AMERICAN SURETY COMPANY OF NEW YORK,
a corporation,
Petitioner and Appellant Below,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a corporation, et al.,
Respondents and Appellees Below.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

ARGUMENT

Petitioner's Point A

Conflicts between Circuit Courts of Appeals on the superior equity of unpaid labor and material claimants.

Recognition of the equitable rights of unpaid laborers and materialmen to funds representing balances due contractors on public contracts, the Government having been fully satisfied by performance, has been accorded generally by the Federal Courts.

In Re P. McGarry & Son (7th Cir.) 240 Fed. 400
Cox vs New England Equitable Ins. Co., (8th Cir.) 247 Fed. 955
Belknap Hardware Co., vs Ohio River Co., (6th Cir.) 271 Fed. 144
In Re Scofield (2nd Cir.) 215 Fed. 45

Alfred Richards Brick Co., vs Rothwell 18 App. D. C. 516

Exchange State Bank vs Federal Surety Co., (8th Cir.) 28 Fed. 2nd., 485

Glades County Bank vs Detroit Fidelity & Surety Co., (5th Cir.) 57 Fed. 2nd., 449

In some of the cases the special equity was decreed to be in the surety by reason of its having paid all of the material and labor claims, the surety's rights being derived from the rights of the laborers and material men whom it had paid. In Exchange State Bank vs Federal Surety Co., (8th Cir.) 28 Fed. 2nd., 458 the contest between the Surety and a bank, as assignee of the contractor, was decided in favor of the Surety. But the contest between the Surety and the bank as assignee of $5793.33 of labor and material claims was decided in favor of the Bank.

The only case claimed by petitioner to conflict with the principle of the other cases is American Surety Company vs Finletter (3rd Cir.) 274 Fed. 152, which involved a City contract in Pennsylvania. The opinion of the Finletter case may well need clarifying, since the Court's ultimate conclusion is not entirely clear, although petitioner construes it as favorable to its contention in the instant case. The United States has always recognized its "equitable obligations to see that the laborers and supply men were paid in connection with its public work contracts." (Henningsen vs United States Fidelity & Guaranty Co., 208 U. S. 404). And we think that the Finletter case, passing upon a City contract in Pennsylvania does not offer such a conflict with the decisions of other Federal Courts on the rights of furnishers of labor and material to the United States, as to call for the action of this Court upon the question.

The origin of the Finletter case is the case of Peoples vs Peoples Brothers 254 Fed. 489, which is apparently the title of the same case in the District Court. The Peoples case held that the surety "on completion of the contract by a Receiver, was not entitled by subrogation to the amount due thereon until claims for labor and materials were paid

in full." The Peoples case has been cited with approval in the following cases:

Maryland Casualty Co., vs Fouts (4th Cir.) 11 Fed. 2nd., 71

American Surety Co., vs National Bank (E. D. Oh.) 17 Fed. 2nd. 942

Pou vs South Carolina Warehouse Co., (E. D. S. Car.) 27 Fed. 2nd. 418

United States vs National Surety Co., 254 U. S. 73

Jenkins vs National Surety Co., 277 U. S. 258

It is submitted therefore that the principle involved in this point is not so unsettled as to require this Court to consider and pass upon the question.

Petitioner's Point B

Conflict between Circuit Courts of Appeals on the effect of the surety's indemnity contract with the contractor, as giving it rights superior to those it acquires by subrogation.

The petitioner says two cases, in addition to the Finletter case, are in conflict with the decision in the instant case. They are:

(1) Exchange State Bank vs Federal Surety Company, (8th Cir.) 28 Fed. 2nd., 485 which was a contest between a surety on the one hand, and a bank assignee on the other hand. It was not a conflict between a surety and labor and material claimants. The decision was governed by Hardaway vs National Surety Company 211 U. S. 552. There is no confusion in the cases on the question that a surety's rights to reimbursement are superior to those of an assignee of the contractor.

(2) National Surety Company vs County Board (4th Cir.) 15 Fed. 2nd., 993. This case, we think, contains no conflict in principle. In the first place, it is concerned solely with North Carolina law in connection with a North Carolina contract. The North Carolina Court has specifically (Robinson vs Blaylock 135 SE 136) refused to recog-

nize the equitable lien principle which the Federal cases, cited under Point A, have applied. In the second place, the labor and material claims involved had not been filed in the one suit on the contractor's bond which had been brought, pursuant to the North Carolina Statute, and in which the Statute provided all claimants should be made parties. In the third place, the Surety had completed the contract, upon the contractor's default and thereupon, as in Prairie State Bank vs United States 164 U. S. 227, became subrogated to the rights of the Public Authority, the obligee in the bond so far as the performance of the work was concerned. In the instant case, the Government was satisfied by complete performance by the contractor.

So far as the rights of the Gevernment, as the bond obligee for performance, and of the laborers and materialmen, as the bond obligees for payment of their bills, are concerned, the principle that the contractor's indemnity agreement with the surety adds nothing to the rights which the surety obtains by operation of law, is one about which there is no uncertainty of decision.

U. S. F. & G. Co., vs Woolridge 268 U. S. 234

Jenkins vs National Surety Co., 277 U .S. 258

Springfield vs American Surety Co., (6th Cir) 7 Fed. 2nd., 44

(expressly approved in Jenkins vs National Surety Company)

Fouts vs Maryland Casualty Co., (4th Cir.) 30 Fed. 2nd., 357

In fact, it is a general and well recognized rule of law that

> "In view of the implied obligation of the principal to indemnify or reimburse the surety an express agreement therefor adds nothing to the surety's rights."
>
> 50 Corpus Juris 257

The indemnity agreement amounts to nothing more than a basis for conventional subrogation. And, disassociated with the surety's rights as surety, would give it no better

right than the bank got as assignee in Henningsen vs U. S. F. & G. Co., 208 U. S. 404, or than Hardaway got in Hardaway vs National Surety Co., 211 U. S. 552.

We submit, therefore, that the opinion in the instant case on this point needs no clarification or confirmation by this Court.

Petitioner's Point C.

Conflict between the Court below and the Supreme Court's decision in Henningsen vs U. S. Fidelity and Guaranty Co., 208 U. S. 404.

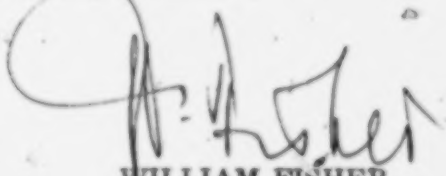
Petitioner urges that the Court below followed Belknap Hardware Co., vs Ohio River Co., (6th Cir.) 271 Fed. 144, in an erroneous construction of the opinion in the Henningsen case. And states the error to lie in the fact that this Court in the Henningsen case determined that the laborers and material men had no rights to which the surety, paying all labor and material claims, could be subrogated; but that the subrogation of the surety necessarily had to be to the rights of the United States.

We submit that petitioner's theory of the Henningsen opinion is incorrect. The opinion, in its second paragraph, recognizes the possibility of subrogation to the rights of laborers and materialmen. It nowhere states to whose rights the surety was subrogated. It does say that the surety "paid the laborers and material men and thus released the contractor from his obligations to them, **and to the same extent released the Government from all equitable obligations to see that the laborers and materialmen were paid.**"

In the instant case the surety has not taken care of all of the equitable obligations resting on the Government, since it has not paid all labor and material claims. And the instant case involves the rights of unpaid labor and material claimants.

The Court below in recognizing the unsatisfied equitable rights of the laborers and materialmen was, we submit, thoroughly in accord with the holding of this Court in the Henningsen case.

Respectfully submitted,



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FILE COPY

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 12

AMERICAN SURETY COMPANY OF NEW YORK,
a Corporation,

Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, a Corporation, et als.

Respondents.

BRIEF OF RESPONDENTS

WILLIAM FISHER,
Attorney for Respondents.

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Respondents.

BRIEF OF RESPONDENTS

Opinion of the Court Below

The opinion of the Circuit Court of Appeals for the Fifth Circuit is in American Surety Company of New York vs. Westinghouse Electric Manufacturing Company et al 75 Fed. 2nd 377.

Statement of Facts

The statement of facts in the brief of petitioner is correct. It does not clearly appear in the Statement of Facts although it may be implied from the facts as stated, that prior to any of the proceedings involving the balance of Twenty-seven Hundred Twenty-four and 23/100 ($2,724.23) Dollars due by the Government to M. J. Gray as the balance of the contract price, the contracted work had been completed by Gray and accepted by the Government, and that the Government's only remaining interest in the matter was that the money be paid to the claimant having the best right to it. (R. 50-R58).

See American Surety Company of New York vs Owens et als 66 Fed. 2nd, 190 for the final result of the case referred to on pages 50 and 58 of the record.

Summary of Argument

The basis of petitioner's argument in support of its superior right to the fund in question here is that the unpaid laborers and materialmen have no equitable lien on or equitable right to priority of payment out of the fund which their labor and materials created; that they occupy with respect to the fund, a position no better than that of any general creditor of Gray whose claim has no connection with the contract or with the fund.

The brief argues its Point I concerning the Surety's right in the fund upon the premise that the respondents have no special equity in the fund. It does not discuss a contest of equities, but relies upon an equitable right in the Surety, and none in the labor and material claimants.

If the petitioner's premise be correct, and if the unpaid labor and material claimants have no special equity in the fund, and no better standing than that of any general creditor of Gray, then the respondents are knocked out in the first round. And there is no need of all the logomachical sparring on the proposition of the surety's rights. Because the respondents have no hesitancy in conceding that the Surety, to the extent it has paid money on account of its suretyship obligation, and by reason of such payment, has acquired a right to the fund superior to the rights of certain other possible claimants, such as a general creditor of the contractor, or an assignee of the contractor, or the contractor himself. So that if there were *no* unpaid labor and material claimants and if the contest here were one between the Surety and a general creditor, an assignee, or the contractor himself, we think the right of the Surety to the fund would be unassailable. But the contest in this case is between the Surety on the one hand, and on the other hand, the laborers and materialmen for the prompt payment of whose claims the Surety was obligated on its bond. It is

a contest of equities between the parties who occupy a certain status toward each other and toward the principal contractor.

For that reason we do not follow the order in which the points are presented in petitioner's brief. But we discuss first the question whether, the Government having been fully satisfied by performance, and none of its rights being involved, the labor and material claimants have any special equity in or an equitable lien on the fund. And secondly, whether the equity which the labor and material claimants have is subordinate to the equity claimed by the surety; and whether the surety occupies such a relationship toward the labor and material claimants as to prevent its competition with them for the fund until their claims have been paid in full.

1.

The Government having been fully satisfied by performance and none of its rights being involved, have the labor and material claimants a special equity in or an equitable lien on the fund?

Petitioner argues that the labor and material claimants can have no equitable lien on the fund because: (1) There is no express contract for such lien; (2) because there is no Statute creating such lien; and (3) because there is no basic reason for implying such lien. It admits, however, that an equitable lien is not dependent upon either an express contractual or a Statutory basis, but may arise by implication out of general considerations of right and justice, where from the relations of the parties and the circumstances of their dealings there is some obligation or duty to be enforced by means of such an implication. For the general principle there is ample authority.

Vidal vs S. A. Securities Corporation 276 Fed. (2nd Cir) 855

Shakers vs Watson 68 Fed. (6th Cir.) 730

Oppenheimer vs Szulerecki (Ill.) 130 N. E. 325

37 Corpus Juris 319

17 R. C. L. 605
Exchange State Bank vs Federal Surety Co., 28 Fed. 2nd (8th Cir.) 485.

The Government has for many years recognized a moral and equitable responsibility to see that persons furnishing labor and material for public work were paid. The Statute under which the bond in the instant case was given (40 U.S. C.A. Section 270) was passed because of the inability of the furnishers of labor and material to acquire a lien upon the public work itself and in derogation of the title of the Government in the work. The Statute was designed to provide an equivalent or substitution for lien legislation.

U. S. vs Ansonia Brass and Copper Co. 218 U. S. 452
U. S. vs Churchyard 132 Fed. 82 Affirmed 204 U. S. 349.

The Statute is susceptible of and should receive a more liberal construction for the benefit of those it is designed to protect, than the ordinary lien Statute.

American Surety Co., vs Lawrenceville Cement Co. (C.C.A.) 110 Fed. 717

And the Statute has always been liberally construed to protect those furnishing labor and materials on public work.

Brogan vs National Surety Company 246 U. S. 257
Illinois Surety Co. vs Davis 244 U. S. 376
Equitable Surety Company vs U. S. 234 U. S. 448

Prior to the amendment in 1905 of the Act passed in 1894, the United States had no priority of rights under the bond as against the laborers and materialmen.

American Surety Co. vs Lawrenceville Cement Co., 135 Fed. 78
United States vs Heaton 128 Fed. 414

And in the bonds given pursuant to the Statute, the laborers and materialmen occupy the status of obligees just as the Government does. The Government is the obligee so far as the obligation for performance is concerned, while laborers and materialmen are distinct obligees so far as the prompt payment of their bills is concerned.

Equitable Surety Co., vs United States 234 U. S. 448
United States vs National Surety Co. 92 Fed 549

Henningsen vs U.S . F. & G. Co., 143 Fed. 810
Glades County Bank vs Detroit F. & S. Co., 57 Fed. 2nd, (5th Cir.) 449

The Henningsen case (Henningsen vs U. S. F. & G. Co., 208 U. S. 404) discussed in petitioner's brief and referred to hereinafter, says that the Government is under an "equitable obligation" to see that laborers and materialmen are paid for their contributions to the contracted work.

In recognition of the Government's attitude toward the laborers and materialmen, and of its design and purpose to furnish them protection, as well as of its equitable obligation to them, the Federal Courts have, with practical unanimity, held that unpaid laborers and materialmen have an equitable lien upon the balance due a public contractor upon completion of the work under the contract.

Alfred Richards Brick Co., vs Rothwell 18 App. D. C. 516
In re Scofield 215 Fed. 144
In Re P. McGarry 240 Fed. 400
Cox vs New England Equitable Ins. Co. 247 Fed. 955
Belknap Hardware Co., vs Ohio River Co. 271 Fed. 144
Exchange State Bank vs Federal Surety Co., 28 Fed. 2nd, 485
Philadelphia National Bank vs MacKinley (App. D. C.) 72 Fed. 2nd, 39
(Certiorari denied Oct. 8th, 1934 ..... U. S. ..... 79 L. Ed. 101)

The opinion in Alfred Richards Brick Company vs Rothwell (supra) says:

> "The Act bears every evidence that it was intended to provide a security for laborers and materialmen on which they could rely confidently for protection, unless they see fit by their own dealings with the contractor to relinquish the benefit of the security. There is, therefore, by necessary implication, an equitable lien and preference secured in favor of the parties who furnish labor and materials in the execution of the contract, in the application or distribution of the contract price remaining to be paid; and where the Government, as in the present instance, holds in its hands

> any part of the money contracted to be paid for the work, and there remain unpaid claims for labor and materials supplied, it holds such funds as quasi-trustee for the benefit of those entitled to receive it under the condition in the bonds; that is to say, the laborers and maerialmen remaining unpaid."

In Re Scofield (supra) the question the Court decided was (Text 47 of 215 Fed.):

> "Whether under the circumstances stated, the Surety of the bankrupt contractor who has paid the claims of the laborers and materialmen has any equity in the so-called reserved fund which it can assert to the exclusion of the general creditors."

The Court then discusses the rights of laborers and materialmen before the passage in 1894 of the Statute requiring a bond for their protection, holds that the contract and bond are to be construed together as the entire contract, and decides the question above stated in favor of a special equity in the surety derived from the claims of laborers and materialmen which it has paid; the Court saying:

> "When the Fidelity Company assumed the obligation of suretyship its equity at once commenced with **its obligation to see that the Scofied Company duly performed all the obligations which the contract with the Government imposed upon it, including its obligations to promptly pay the laborers and materialmen."** (Blackface supplied).

In Cox vs New England Equitable Ins. Co. (supra) the right of the surety to an equitable lien on the balance of the contract price was derived from the right of the laborers and materialmen whom it has paid. And the same is true of in re McGarry, supra.

Belknap Hardware Company vs Ohio River Co. (supra) has this to say of the Henningsen case (Text 148-149 of 271 Fed.):

> "The case was essentially different from the Prairie State Bank case, because there the Surety had taken over and completed the contract and the performance of the contractor's obligation to the United States as the other party to the contract, and so had become en-

titled to the security which the United States held against the contractor; in the Henningsen case, the contractor himself had completely performed the contract and had finished the work. It would seem, therefore, that subrogation in the Henningsen case could not be to any security which the United States held against the contractor; there was no such element in the case. The Surety's claim of priority in the fund was sustained and this was done on the stated theory of subrogation. Since there cannot be the transfer of a right by subrogation, unless there is a right to be transferred, we think, the necessary effect of the decision is to hold that laborers and materialmen, in spite of or in addition to the giving of the bond, had an original and continuing equitable priority in the fund, and that it was this right to which the surety was subrogated. This is not stated in the opinion in very express terms, but it had been pressed upon the Court (208 U. S. 407, 408, 28 Sup. Ct. 389, 52 L. Ed. 547) that there could be no such subrogation without such a right and that there was no such right. On page 410 of 208 U. S., on page 391 of 28 Sup. Ct. (52 L. Ed. 547) the Court refers to and assumes that the Government, after the bond was given was still charged with 'equitable obligations to see that the laborers and supply men were paid. We are constrained to think that the decision necessarily rests upon the existence of this right, as one entitling these claimants to priority in payment out of the fund, and therefore, as entitling the surety, as their equitable assignee by subrogation, to the same priority."

And in Philadelphia National Bank vs McKinlay (1934-supra) it was held (2nd Headnote):

> "Person furnishing labor and material for Government project has equitable lien on the contract price until fund is paid to general contractor, irrespective of statutory bond."

In adition to these authorities, many of the cases cited by petitioner as sustaining the right of surety in unpaid balances on a public contract, recognize the equitable rights of laborers and materialmen, and derive the Surety's right from them through payment by the Surety of their claims. As for instance, Wasco vs New England Equitable Co., (Ore.) 172 Pac. 126, where the contest was between a surety who had paid labor and material claims in full, and a Bank

assignee of the contractor. And Johnson Service Co., vs Monin 253 N. Y. 417, 171 N. E. 682 which did not involve a contest between a surety and a materialman, but which recognized the equitable right of the materialman to be paid out of the reserve fund. And Illinois Surety Co., vs City of Galion 211 Fed. 161 in which the Court said:

> "I am of the opinion that the fund now in Court is subject to the payment of all unpaid labor and material claims that went into the work of construction of the sewage disposal plant at Galion and that the complainant has the right in equity to see that this money, which has been paid into Court, should be applied to the liquidation of all claims for material and labor that have arisen under the contract in question . . . . ."

in deciding the case against a bank creditor of the contractor.

And of the authorities cited on page 40 of petitioner's brief as holding against the existence of an equitable lien in favor of laborers and materialmen, only two, viz: Robinson vs Blaylock (N.C.) 135 S. E. 136, and American Surety Co., vs Finletter 274 Fed. 152, both of which involve State Statutes and contracts other than Federal, support petitioner's theory. Freeny vs Bauernschmidt 33 Fed. 2nd, 709 involved no Statute such as the one here in question, and was decided upon authority of the Maryland cases which had established the rule which the Federal Court followed. In Pratt Lumber Co., vs Gill 278 Fed. 783, no rights of laborers and materialmen were involved, and in the case the Court cited with approval Alfred Richards Brick Co., vs Rothwell, supra (18 App. D. C. 516). In re Fowle 213 Fed. 676 was a case where there was no provision in the bond requiring the contractor or his surety to pay labor or material claims. Kellas vs Slack 99 Atl. 677 is another Maryland case involving no Statute or bond, but in the case the equitable right of a labor and material claimant was upheld as against an assignee of the fund, no right of the public authority being adversely affected. Sexaver and Lemke vs Burke (N.Y.) 127 N. E. 319 involved the New York mechanics' lien law and its effect upon a private owner. Southern Surety Co., vs Schlesinger, as cited on page 40 of

petitioner's brief apparently should be Southern Surety Company vs Merchants and Farmers Bank (Ind.) 176 N. E. 846.

That case is direct authority supporting the equitable rights of laborers and materialmen. The Surety was held not to be entitled to subrogation because it had not paid the laborers and materialmen. And the Court held that the order of he Court below relative disposition of the balance of the contract price "should have been that the County officials pay said retained fund into Court and directed the Clerk to apply the same pro rata on the labor and materialmen's judgments, as said judgments amounted to more than said fund, and this shall be the order of this Court, with the further direction that in the event said labor and material men's judgments has (sic) been paid by appellant, then said money to be paid to appellant herein."

Robinson vs Blaylock, supra, involving a North Carolina statute, and contractor's bond, is however direct authority supporting petitioner's contention. The North Carolina Court refuses to recognize the equitable lien theory in favor of laborers and materialmen which the Federal Courts have enforced.

And American Surety Co., vs Finletter, supra, is construed by petitioner as holding that labor and material claimants on a Pennsylvania municipal contract have no better status than general creditors with respect to reserved funds. We think that is the result which may be deduced from the opinion in the case, and, if the deduction is correct then the case is authority against the claim of the respondents to an equitable lien. The same case in the District Court appears to be Peoples vs Peoples Bros. 254 Fed. 489 which held, on the same proposition as that decided in the Finletter case, that the surety

> "on completion of the contract by a receiver was not entitled to subrogation to the amount due thereon until claims for labor and materials were paid in full."

The Peoples case has been cited with approval in the following cases:

Maryland Casualty Co., vs Fouts 11 Fed. 2nd, (4th Cir.)

American Surety Co. vs National Bank (D. C. Oh.) 17 Fed. 2nd, 942

Pou vs South Carolina Warehouse Co., (D.C.) 27 Fed. 2nd, 418

United States vs National Surety Co., 254 U. S. 73

Jenkins vs National Surety Co., 277 U. S. 258

so that the weight of the authority as between the Peoples case and the Finletter case would appear to sustain the respondents in the instant case, rather than the petitioner.

So much for the authorities which have passed upon the question of whether or not laborers and materialmen have an equitable lien upon or equitable right of priority of payment from the balance due upon a public contract, the Government having been fully satisfied by the performance of the contract by the contractor. From Alfred Richards Brick Co., vs Rothwell, supra, decided in 1901, on down through In Re Scofield, supra, and other cases cited, together with Henningsen vs U. S. F. & G. Co., supra, (208 U. S. 404) the Federal Courts have, without exception so far as Federal contracts are concerned, accorded definite recognition to the equitable rights of laborers and materialmen, so long as no adverse rights of the Government existed.

One of the time worn arguments against the existence of an equitable lien in favor of laborers and materialmen, and one which petitioner urges in its brief, is that the recognition of such a lien by the Courts must necessarily open the way for laborers and materialmen to embarrass the Government; and that such lien will necessarily limit the right of the Government to use the proceeds of a public contract for its own protection, or to disburse such proceeds in its inrestricted discretion. The brief says (Page 36) "If the Government has an equitable obligation that transcends even the bond, it is timely to inquire as to the limitations of this obligation."

The Courts have found no such difficulty in their equitable lien cases. It certainly is not necessary, in the conception of such a lien, to say that the lien would destroy the paramount right of the Government to a complete per-

formance of the contract as to it or would hamper its unrestricted discretion in the disbursement of the contract proceeds in accordance with the terms of the contract. A lien even on tangible property frequently is effective as between certain parties to a transaction and ineffective as to other parties to the same transaction. And an equitable lien dealing with intangible property, such as this case, presents no technical difficulty to a Court called upon to pass judgment on such relative equities as various parties to a transaction may acquire in the course of the transaction. And it does not necessarily follow that recognition of the existence of an equitable lien in a case such as this where the Government has not paid the contractor but has delivered the money into Court for the purpose of having it paid to the claimant with the best right to it, that the Government could not have paid out the money to the contractor, under the terms of the contract, free from a lien.

Besides, how can the equitable lien of the labor and material claimants embarrass or hamper the Government to any greater extent than the Surety's claim of an equitable lien or equitable priority in the fund? The Government had in its hands the unpaid balance due on the contract. The Surety claimed the right to bring the Secretary of the Navy into Court to require that the money should be paid to it. Yet it urges that to permit a labor or material claimant to do the same thing is such a destructive and pernicious theory as to render the existence of an equitable lien in his favor impossible. The Surety in Glades County Bank vs Detroit F. & S. Co., 57 Fed. 2nd, 449, went into Court to compel the public authority to make disbursements of the proceeds of a public contract to the laborers and materialmen whom the surety claimed the right to have paid out of such proceeds. Certainly, the recognition of an equitable lien in laborers and materialmen as against the contractor upon his default in payment of claims, or as against his assignee or his general creditors, would not have to mean that the same lien would exist as against the Government's rights under the contract.

Petitioner argues that it is reasonable to assume that the laborers and materialmen relied for the collection of their money, wholly upon the contractor's financial stability and upon the penalty of the bond, and that therefore they can have no equitable lien on the proceeds of the contract. The amount of the contract was $13,133.36 (R9) plus $2109.64 (R23) or a total of $15,243.00. This minus the contractor's profit would constitute the cost of the labor and materials necessary to create the structure the contract called for. The bond, a part of the contract, obligated the principal that he should "promptly make payment to all persons supplying the principal with labor and material in the prosecution of the work". (R 20). The contract (R 17) provided for partial payments by the Government from time to time, obviously for the purpose of enabling the principal to pay for the work as it was being carried on. And the contract also provided (R 17) that "All material and work covered by partial payments made shall thereupon become the sole property of the Government . . . . ." The penalty of the bond was only $3940.00. It seems to us a much more reasonable assumption that laborers and materialmen would know that it would take the payments made by the Government from time to time on account of the contract price to pay their claims for labor and materials furnished. And that they would rely upon the contract payments by the Government for payment, and on the penalty of the bond only for any deficiency after full use of the proceeds of the contract. That would be the view, too, we take it, of the Government, and of the surety and of the principal contractor. And that arrangement is all the respondents have ever asked for, that the proceeds of the contract be applied as far as they will go to pay their bills, and that the bond penalty supply the deficiency.

And petitioner argues that a discretionary retention of funds under the contract does not establish an equitable lien on the funds. In re Scofield Co., supra and Greenville Savings Bank vs Lawrence (CCA 1896) 79 Fed. 545, say that funds retained, even if they were retained under a discretionary right, were, under circumstances as they exist

in the instant case, subject to an equitable lien in favor of the laborers and materialmen. Kane vs First National Bank (5th Citr.) 56 Fed. 2nd 534, cited by petitioner to support this contention concerned funds which had **not** been retained, but which had been paid out by the Public Authority to the principal contractor and by him disbursed. But we do not think that respondents' rights are dependent upon the provisions of the contract fixing the times at which or the manner in which the contract proceeds are to be paid by the Government to the contractor.

We confess ourselves unable to follow the distinction, so far as an equitable lien in respondents is concerned, between the 10% reserved fund in the contract, and any other unpaid portion of the contract proceeds. Such a distinction is a valid one where a question of the release of the surety is claimed by reason of premature payments made by an obligee in the bond. But here the contract had been fully performed and $2724.23 remained of the contract proceeds payable, but unpaid, to the contractor. The surety had not been called upon to perform any part of the contract obligation to the Government. And regardless of the purpose of the 10% reserved fund to safeguard the completion of construction, construction had been completed and the 10% reserved fund was in no different situation than any other unpaid portion of the contract price. It seems to us that the 10% provision in the contract is simply a provision fixing the time of payment of that amount rather than a distinct allocation of that percentage to any different purpose from the purpose of any other portion of the contract price. For it seems clear that if a contractor should default when he has collected only some, or none, of the partial payments provided to be made from time to time as the work progresses, then the unpaid partial payments would be usable by the Government in the same manner, for the same purpose and to the same extent as the 10% reserved fund. See McGowan vs United States 35 Ct. Cl. 606 (1900) and United States vs U. S. F. & G. Co. (1915) 236 U. S. 512.

It is difficult to see how the times at which the contract says partial payments are to be made to the contractor, can

have any effect upon the equitable obligation which the Government recognizes to see that, subject to its paramount right of complete performance as to it, the laborers and materialmen whose work and materials created the the fund should be paid.

The petitioner argues that the lien of respondents must be limited to that part of the contract proceeds which the Government had no discretionary power to pay out. Why? What is the difference between the two funds unless the equitable lien is held to exist only because of some express allocation under the terms of the contract? The petitioner attempts to divide the $1524.00 which constitutes 10% of the contract price, and to limit respondents' rights to half of the $1524.00, because the contract provides (R 17): "In making such partial payments there shall be retained 10 per cent on the estimated amount until final completion and acceptance of all work covered by the contract; provided, however, that the contracting officer, at any time after fifty per cent of the work has been completed, if he finds that satisfactory progress is being made, may make any of the remaining partial payments in full."

Even if the equitable lien of respondents had to be predicated upon an express allocation in the contract, and had to be confined to the 10% reserved fund, it is difficult to see how a distinction can be made between the two halves of the $1524.00. If satisfactory progress was not being made either by performance of the work, or by performance of the undertaking to pay for the labor and materials used, the contracting officer had the right to keep both halves of the $1524.00, and both halves remained in the same category so far as allocation might be concerned.

We submit, therefore, that the authorities sustain the equitable lien claimed by respondents, and that there are no reasons urged by petitioner which would require the Supreme Court to change the rule established by the Circuit Courts of Appeals in the different Circuits recognizing such a lien. The question remains, then, as to the relative rights of the petitioner and of the respondents in the contest of

their equities in the fund, and whether the petitioner is entitled to compete with respondents for the fund.

2

The Equity of Respondents in the Fund is Superior to any Right of the Surety.

The petitioner argues its right to the fund, under its point I, upon the assumption that the respondens have no equity in the fund in question, and stand in no better situation with reference to the fund than any general creditor of the contractor. And the petitioner studiously attempts to avoid subrogation as a basis of its claimed right. It contends that its right is a direct right based upon: (1) The indemnity agreement signed by the contractor. And (2) Equitable principles analogous to subrogation. And further (3) that the Court must uphold its right to the fund because a failure to make its right superior to the rights of the respondents would impair its rights under its contract (i.e. of indemnity) with the contractor.

A

The petitioner's Indemnity Agreement with the Contractor gives it no better right as against the Respondents than it obtains upon the theory of subrogation.

To begin with, we think the petitioner has proceeded upon an incorrect assumption of what the terms of the indemnity agreement are. We construe the Agreement to be, by its terms, an agreement for subrogation, and we think that its terms entitle it to be called nothing more than a basis for conventional subrogation; and that it adds no force or strength to the subrogation to which the Surety would, without the agreement, be entitled by operation of law. The agreement begins (R 31) by basing the indemnity agreement upon the Suretyship contract or relationship. It obligates the principal (R 44 Par. III) to "perform all the conditions of said bond" one of the conditions being to make prompt payment to all furnishers of labor and material. It

then, in event of the principal's default, expressly assigns to the Surety (R 45 Par. III) certain materials, and rights under sub-contracts. And it (R 46) expressly does not assign to the Surety the principal's right under the contract with the Government but provides that

> "the said Surety, as surety, shall be subrogated to all the rights and properties of the indemnitor in such contract, and that deferred payments and any monies and securities that may be due and payable at the time of such default, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract, shall be credited for any claim that may be made upon the said Surety by reason of its suretyship as aforesaid."

The instrument specifically provides for subrogation and it does not provide that the money coming to the contractor shall be paid to the Surety to reimburse it for claims against it which it may have paid but provides that such money shall be "credited for any claim that may be made upon the said Surety"; or, in other words, that the money shall be ear-marked to be applied to claims made on the Surety, even in advance of any payment of such claims by the Surety.

Regardless of the effect of the agreement as a basis for an expressly created equitable lien or as a basis for conventional subrogation, it is clear that whatever rights in the proceeds of the contract the agreement gives to the Surety are given to it by reason of its suretyship, as an incident to such suretyship, and adds nothing to the rights in the unpaid proceeds of the Contract which would exist in the Surety by operation of law.

If the indemnity contract be considered as an assignment to the Surety of the contract proceeds, separate and distinct from its relationship to the transaction as Surety, then the assignee would obtain no greater rights under the assignment than Hardaway got in Hardaway vs National Surety Company (211 U. S. 552) or the bank assignee in Henningsen vs U. S. F. & G. Co., supra. Petitioner claims (Brief Page 17) that this analogy is unsound because the

respondents have no equitable right whatever in the fund. Of course, petitioner's conclusion is correct if the Court holds that there is no equitable lien or equitable right in respondents. But if it be true, as we think the authorities heretofore cited show it to be, that the respondents as labor and material men do have a recognized equity in the fund, then petitioner's criticism of the analogy is not a valid one. And the necessary result of the petitioner's criticism of the analogy is an admission that the indemnity agreement is of no more force, considered from the standpoint of an assignment of the contract proceeds, than the assignments in the Hardaway and Henningsen cases, since the assignments in the latter two cases would have the effect of giving the assignees priority over the general creditors of the contractor, and consequently over the labor and material claimants if their position is no better than that of a general creditor.

The general rule is that when a contract of suretyship is made there arises an implied contract that the principal will indemnify the Surety for any payment the latter may make to a creditor of the principal in compliance with the suretyship obligation. 50 Corpus Juris 255.

In Springfield National Bank vs American Surety Co., (6th Cir.) 7 Fed. 2nd 44 (expressly approved in Fouts vs Maryland Casualty Co., 4th Cir. 30 Fed. 2nd, 357 and in Jenkins vs National Surety Co., 277 U. S. 258) the Court in speaking of an indemnity agreement on which the Surety relied, said (Text 45):

> "This provision did not give to the Surety Company any right that it otherwise did not have upon the execution of the bond, for there is always an implied obligation, in the absence of an agreement to the contrary that the principal will indemnify the Surety against loss resulting from the suretyship".

See also

Fouts vs Maryland Casualty Co., (4th Cir.) 30 Fed 2nd, 357, supra,

Jenkins vs National Surety Co., 277 U. S. 258 supra.

Petitioner's attempt (Brief Page 10 et seq) to distinguish the Jenkins case from the instant case is based upon its assumption that the respondents had no right to look to the contract proceeds here for payment of their claims and had no equity in such proceeds. And petitioner says that the indemnity agreement in the Jenkins case was a "very general one" (whatever distinction between it and the one in the instant case that phrase may mean), and also one which did not specify any particular portion of the principal's assets out of which the indemnity to the Surety was to come. And that here the contract proceeds were specifically made the security of the Surety. Even if petitioner's distinction were sustainable from a factual standpoint, the Jenkins case would still be a sufficient authority for the position taken by respondents. Respondents are obligees in the bond made by the principal and Surety. And the Surety was bound as surety to them. The bond was conditioned upon the prompt payment (not partial payment) to "all persons supplying the principal with labor and materials in the prosecution of the work provided for in said contract" (R 20). The indemnity agreement bound the principal to perform all the conditions of the bond (R 44). The Jenkins case (Text 267 of 277 U. S.) says:

> "Similar reasoning underlies the requirement of equity that the surety who holds the security of an insolvent debtor must give the benefit of it to the creditor for whom he is surety until the debt is fully paid."

But we think the attempted distinction would increase the force of the Jenkins decision as authority for the position of the respondents here with reference to the effect of the indemnity agreement. In the Jenkins case the obligee in the Surety's bond was a general creditor of the principal. And the independent indemnity agreement executed by the principal was used by the Surety in its attempt to place itself, not in the position of a secured creditor as it attemps to do here, but simply in the position of a general creditor whose claim against the principal was based upon the obligation expressed in the indemnity agreement. In

the two cases cited by petitioner on page 14 of its brief, viz: U. S. F. & G. Co., vs Centropolis Bank 17 Fed. 2nd, 942, (both of which were overruled by the decision in the Jenkins case), as well as in National Surety Co., vs Jenkins 18 Fed. 2nd, 707 (which was reversed by the Jenkins case in the Supreme Court), it was held that the separate contractual relationship between the principal and the Surety was a sufficient basis to make the Surety a general creditor of the principal and as such that the Surety had a right to file its claim as a general creditor. In none of those cases did the Surety attempt to claim a priority over its obligees. The decision in the Jenkins case in the Supreme Court was, therefore, definitely and distinctly to the effect that the indemnity agreement, no matter how considered, could not give the Surety any better right than it acquired by operation of law under the theory of subrogation. The cases heretofore cited dealing with the rights of laborers and materialmen, and of sureties which had paid labor and material claims all based the right of the Surety upon the subrogation, and not on an express indemnity agreement.

For the reasons stated and upon the authorities cited we submit that the petitioner's indemnity agreement with the contractor gives it no better right as against the respondents than it obtained upon the theory of subrogation.

B

The Subrogation Right of the Surety must be derived from the rights of the creditors whom it pays.

The petitioner argues that "equitable principles analogous to subrogation" entitle it to the reserved fund. And that it ought to be subrogated to the rights of the Government, notwithstanding it has performed none of the contractor's obligation to the Government, or to the rights of the contractor, although the contractor is not an obligee under the bond which the Surety executed as surety. It does not seem necessary to complicate the situation in this case by departing from the principles of subrogation on a search for principles analogous to subrogation. But it is not difficult

to see why the petitioner desires to avoid applying the principles of subrogation in a determination of its rights here.

It is difficult, however, to see how the surety can claim any right as subrogee of the contractor since the contractor is not a creditor whose claims have been paid. And it is still more difficult to see how a claim of the surety as subrogee of the contractor would give it any preferred standing as against the claims of the laborers and materialmen which the contractor owes and which he is in duty bound to pay. If the surety stands as subrogee of the contractor then its rights can rise no higher than his rights to the fund in question. It is clear, of course, that the government could have paid the money to the contractor in the ordinary course of events, during the progress of the contract, and the contractor could have spent the money as he saw fit. There is no principle which would involve the hampering of the government in its dealings with the contractor with respect to the payments to be made under the contract. But it is equally clear, we think, under the authorities hereinbefore cited as authority for the existence of an equitable lien in favor of laborers and materialmen, or in favor of the surety who has paid the labor and material claims, that where the situation in connection with a particular contract develops to the point where the contract has been performed so far as the government is concerned and there remains simply a question of equitable distribution of the unpaid balance of the contract price, laborers and materialmen have a superior right in the fund to the right of the insolvent contractor. If that were not true a contractor's assignment of his rights to such fund to a bank would take precedence over the rights of the laborers and materialmen to be paid out of such fund, or would take precedence over the right of a surety, who has paid labor and material claims, to be repaid out of such funds. So that on the surety's contention that it stands in the shoes of the contractor, the question arises as to the relative equities of the laborers and materialmen on the one hand and of the insolvent contractor on the other hand to the fund. And we think it requires

no additional citation of authority to establish the proportion that as between those two classes of claims the laborers and materialmen have a superior right to the contractor. In bankruptcy, the fund is in the hands of a court of equity to be delivered to the claimant most equitably entitled to it. If the contractor has a better right than the laborers and materialmen, then it would go to the general creditors instead of to the laborers and material claimants, absent any other phase of the controversy. That would be the result of any theory that the insolvent contractor, or one standing in his shoes has a superior equity to the labor and material claimants.

In support of its claim that it is entitled to the fund in question by subrogation to the rights of the Government under the Gray contract, petitioner relies on some cases which it is not necessary to discuss, but principally on

Prairie State Bank vs United States 164 U. S. 227 and
Henningsen vs United States 208 U. S. 404

In the Prairie State Bank case the surety completed the perfromance of a contract on the contractor's default, and thereby performed the obligation to the United States. It was no departure from the principles of subrogation to say that the Surety, which had completed the construction called for in the contract became subrogated to the rights of the Government which was the obligee for such completion. And the right which the Surety acquired by subrogation to the right of the creditor it paid was held good as against a bank assignee. In the instant case, the contractor himself completed the contract and therefore satisfied the obligation of the contract and of the bond to the Government.

In the Henningsen case the contest was between a surety which had paid all of the material and labor claims, and a bank assignee of the contractor. And it is believed that the whole contention of the petitioner in the instant case is based upon its theory that in the Henningsen case the Supreme Court failed to hold that laborers and materialmen

had any rights to which the Surety could be subrogated, and that, consequently, the rights accorded the Surety must have been derived by subrogation to the rights of the Government.

We have already discussed the cases in the Circuit Courts of Appeals which have accorded definite recognition to the equitable rights of laborers and materialmen, including Belknap Hardware Company vs Ohio River Co., 271 Fed. 144 which concluded that the subrogation involved in the Henningsen case was in fact a subrogation to the rights of the laborers and materialmen. The Henningsen case, in the lower Court, is

Henningsen vs U. S. F. & G. Co., 19th Cir. 143 Fed. 810
In that case the Court said (Text 814):

> "Whereas in the Prairie State Bank and Rundle cases, supra, the surety is compelled to make good the default of his principal as respects the Government, the surety is, as was distinctly held in those cases, entitled to be subrogated to the rights of the Government. **Upon precisely the same principle the surety is entitled to be subrogated to the rights of laborers and materialmen,** whereas, in the present case it is compelled by reason of the obligations of the bond to pay them for labor and material because of the default of its principal."

In its opinion affirming the Henningsen decision of the Circuit Court of Appeals, the Supreme Court did not state in so many words, the right to which the Surety was held to have been subrogated. It did, however, affirm the lower Court and approve its conclusions. And, speaking of the Surety's right, the Court said:

> "It paid the laborers and materialmen and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that the laborers and materialmen were paid."

Even if the Supreme Court did not, in express terms, define the rights of laborers and materialmen in the Henningsen case, or state whether it was to their right or to the right of the United States that the surety was subrogated, it did

recognize an equitable obligation on the part of the Government to see that the laborers and materialmen were paid. And either the laborers and materialmen had rights to which the surety, by paying all of their bills, was subrogated, or else the Surety succeeded to the right of the United States subject to the equitable obligation to the laborers and materialmen. And it succeded to the right of the United States, not by performing the contract, but by relieving the United States of all its equitable obligation to the laborers and materialmen. In either view of the case, the result would be the same in the instant case, because, until the Surety relieves, by performance, the whole of the obligation of the United States, it would not be entitled to be subrogated to rights of the United States.

The views expressed by the Belknap Hardware Company case, and by the Henningsen case in the Circuit Court of Appeals logically follow the recognition of any equitable rights in the laborers and materialmen. Only by denying them any equitable rights, even though such rights (and they are) subordinated to the right of the Government for complete performance, can any conclusion be reached other than that, by performing its principal's obligation to the labor and material obligees in its bond, the Surety becomes subrogated to the rights of the obligees whom it pays. All of the Federal Courts have recognized the equitable rights of the laborers and materialmen, and no injurious effect on the Government's rights have resulted.

We submit, therefore, that such right as the Surety has in the instant case comes to it through subrogation to the rights of the creditors it pays, and not through subrogation to the rights of the contractor of the United States.

C

Does Recognition of the Equitable rights of the respondents constitute an impairment of the petitioner's rights under its indemnity agreement?

This contention of petitioner (Brief, Page 29) proceeds upon the assumption that a superior right of the Surety is being subordinated to an inferior right of the respondents by the arbitrary action of the Court. Whereas the instant case is for the purpose of deciding whether or not the rights of the respondents are superior or inferior to the rights of petitioner.

Of the three cases cited by the petitioner as supporting its contention, the two in the lower Federal Courts simply involve the proposition that an obligee in a bond, conditioned on the princapal's performance of a contract, releases the Surety by not complying with the contract provisions governing the times of payment of the contract price. The Prairie State Bank case, already discussed, involved a contest between a surety, and a bank assignee of the contractor.

A decision that the equitable rights of the respondents are superior to those of the petitioner would no more impair petitioner's contract than does any enforcement of a superior lien impair the contract of any holder of an inferior lien.

A mortgage on real estate is liable to be impaired by a superior lien, whether the superior lien be a first mortgage or a lien for work or materials. The petitioner took its contract from Gray, and assumed toward the respondents the status of surety guaranteeing that Gray would perform his obligations to them. The contract was taken subject to the acquisition by the respondents of the equitable rights which the cases had upheld. Just as a mortgage on real estate is taken subject to the risk of liens of laborers and materialmen engaged in the construction of improvements on the real estate, if, subsequently, they are not paid for

their labor and materials. And the enforcement by a Court of their superior lien does not operate as an impairment of the contract represented by the mortgage. The question here is whether the respondents' equity is superior to that of the petitioner. If it is superior then its enforcement cannot operate as an impairment of the petitioner's contract with the defaulting contractor. If it is not superior, then respondents have no right to have it enforced. So the petitioner's objection that to enforce respondents' equity, if it is superior to that of petitioner, would be to impair petitioner's contract is begging the real question before the Court.

D

The effect of Petitioner's relation-back theory.

The petitioner argues its "relation-back" contention in connection with its theory that the indemnity agreement gives it a better right than it would acquire by subrogation, although the relation-back principle is applied by the cases cited by the petitioner to rights based on subrogation.

The relation-back principle is stated thus in 50 Corpus Juris 255:

> "This implied contract arises when the suretyship is made and when payment is made thereunder. Payment merely fixes the amount of payment for which the principal is liable and relates back to the time when the contract was entered into; but the theory of relation cannot be invoked to do injustice as against third parties."

See also

Gilbertson vs Northern Trust Co., (N. Dak.) 207 NW 42
U. S. F. & G. Co. vs Woolridge 268 U. S. 234,

in which latter case the Supreme Court said:

> "The doctrine of relation is a legal fiction intended to promote the ends of justice. It is never allowed to defeat the collateral rights of third persons lawfully acquired."

Under those authorities as well as under
Jenkins vs National Surety Co. (Supra) 277 U. S. 25
Exchange State Bank vs Federal Surety Co., supra
Fouts vs Maryland Casualty Co., supra.
Springfield vs American Surety Co., supra

the relation back theory can have no effect on the rights of the respondents who are obligees of the Surety, regardless of the fact that the superior equity of the respondents became operative subsequent to the origin of the suretyship contract. It might as well be argued that the relation back theory would serve to give the surety priority over any claims of the other obligee in the bond, the Government, in event of default subsequent to the inception of the suretyship.

E

The petitioner has no right to compete with the respondents for the fund until the respondents' claims are paid in full.

The respondents are obligees in the bond on which the petitioner was surety.

Equitable Surety Co., vs United States 234 U. S. 448
United States vs National Surety Co., 92 Fed. 549
Henningsen vs U. S. F. & G. Co., 134 Fed. 810
Glades County Bank vs Detroit F. & S. Co., 57 Fed 2nd 449.

That being so, the contest here is between a surety on the one hand, and obligees (or creditors of the principal) whose claims against the principal have not been fully satisfied, on the other hand.

The petitioner takes the position that the complete obligation of the bond to appellees was satisfied by the payment into Court of the penalty of the bond. It tentatively suggests, though apparently without confidence in the suggestion (Brief, Page 27) that the condition in the bond requiring the principal to make prompt payment to all persons supplying him with labor and materials means that if the principal should pay small portions of each labor and

material bill, just so he made sure that all claimants got a little something each, the condition would be performed, according to the intent and purpose of the bond.

The bond required the principal to pay all labor and material bills. The Surety guaranteed to the laborers and materialmen that the principal would perform that condition of the bond. It is true that the amount that could be recovered from the Surety for breach of this condition was limited to a certain figure, but the limitation on the amount of recovery against the Surety did not limit or purport to limit the extent of the obligation to pay all labor and material bills. The duty of the principal was not to pay $3940.00 worth of labor and material bills, but to pay them all, and the Surety guaranteed he would do it. That duty is still unperformed. The Surety, by paying the $3940.00 put itself in a position to defend against further demands on it by the obligees, but only because that amount was all it had agreed to pay for a breach by the principal of his duty of payment. But the Surety claims now that it cannot only use its payment of $3940.00 as a defense against further recovery, but that its payment gave it the right to take the offensive against and in competition with the unpaid creditors of its principal.

The situation is analogous to that in Maryland Casualty Co., vs Fouts 11 Fed. (2nd) 71 (expressly approved in the Jenkins case, supra, (277 U. S. 258) where the Court said:

> "The penalty of the bond in this case, it is true, was $50,000.00, and, subsequent to the bank's failure, the amount of the penalty was paid by the surety; but the whole obligation to the State was by no means extinguished. On the contrary, there remained a balance of $39,579.14 due. The condition of the indemnity bond was to pay upon demand all money deposited in said bank, no limitation in amount being placed thereon, as set forth in full in the provision of the bond hereinbefore set forth. Manifestly, the surety therein could not assert a claim, either by way of subrogation or otherwise on account of what it saw fit to pay on its bond indemnity, as an admitted liability, leaving unpaid such portions thereof as it saw fit-not to settle."

The same language, substituting "contractor" for "bank" and "laborers and materialmen" for "the state", and "labor and material claims" instead of "money deposited in said bank", could be fitly used in the instant case.

Suppose the unpaid balance of the contract amounted to $3940.00, the exact penalty of the bond. The Surety then would pay into Court the penalty of its bond, and, notwithstanding the failure of its principal to perform his duty of payment, a duty which the surety guaranteed he would perform, would claim complete reimbursement. It would, therefore, suffer no loss for breach of the principal's obligation, but would cause the entire loss to fall upon the very persons to whom its principal and it owed the duty of payment. The principle is the same with respect to the partial reimbursement it seeks here in competition with its unpaid obligees.

In

State for the Use of LeFlore County vs First National Bank of Greenwood, 66 Fed. (2nd) 9

the surety had executed bonds which guaranteed some, but not all, of a County's deposit in a bank. Upon the failure of the bank, the surety paid the County authorities the full amount of the bond penalties, took assignments from the bond obligees of their claims against the bank to the extent they had been settled by the bond penalties, and sought to prove its claim against the insolvent bank. The Court held that the surety had no right to prove its claim against the bank in competition with the County, even though the remaining County claims were for deposits which were not protected by the bonds. The Court said:

> "This, in connection with his other findings, was a finding that, though the surety became bound for only a part of the debt, the obligation of their principal, the bank, was an indivisible one for all County funds including those of the Sheriff and tax collector. The conclusion that under these circumstances the sureties are entitled to subrogation is in direct conflict with the general rule that one is not entitled to be subrogated

> to the rights and securities of a creditor until the claim of the creditor against the debtor has been paid in full."

And later in the same opinion announced as a rule:

> "The surety who pays the amount called for by the bond does not thereby become subrogated to the rights of the creditor to the prejudice of the balance due the latter."

This rule is in accord with our previous quotation from Maryland vs Fouts (supra, 11 Fed. (2nd) 71), in which latter case the Court quoted from United States vs National Surety Company, 254 U. S. 73, as follows:

> "This result is in harmony with a familiar rule of the law of subrogation under which a surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied."

In Jenkins vs National Surety Co. (supra, 277 U. S. 258), where the penalty of the bond was insufficient to satisfy the whole claim of the obligee against the principal, the Supreme Court said:

> "The established rule that the surety may not claim subrogation against an insolvent debtor until the creditor is paid in full is a recognition of the inconsistency of that position. (Citing cases.) The rule would go for naught if, by claiming indemnity instead of subrogation, the surety would achieve the same result. The same policy against permitting a surety to compete with a creditor for the insolvent debtor's assets requires that the surety be denied subrogation to security given by a creditor for several debts for only one of which the surety is obligated. Similar reasoning underlies the requirements of equity that the surety who holds the security of an insolvent debtor must give the benefit of it to the creditor for whom he is surety until the debt is fully paid." (Citing cases.)

CONCLUSION

In the instant case the surety, who guaranteed full payment by its principal of all the claims of appellees, is in direct competition with the creditors of the principal. The

payment by the surety of the full penalty of the bond did not result in the performance by the principal of the duty undertaken by the bond, the performance of which the surety guaranteed. We submit that it is clear, in reason and principle as well as upon the authorities referred to, that:

(1) The appellees have an equitable lien on or priority right in the fund in dispute.

(2) That the appellant surety has no right in the fund to the prejudice of the claims of appellees and their right to full, not partial, payment of the claims.

Therefore, the judgment of the Court below is correct and should be affirmed.

Respectfully submitted,

WILLIAM FISHER,
Attorney for Respondents.

The assignment contained in the indemnity agreement upon which petitioner so strongly relies is absolutely void under the provisions of Sec. 3477 of the Revised Statutes. London & Lancashire Indemnity Company v. Endres, 290 Fed. 98; National Bank of Commerce v. Downie, 218 U. S. 345, 31 Sup. Ct. Rep. 89, 54 L. ed. 1065; Nutt v. Knut, 200 U. S. 12, 26 Sup. Ct. Rep. 216, 50 L. ed. 348.

R. S. Sec. 3477; May 27, 1908, c. 206, 35 Stat. 411:

"ASSIGNMENTS OF CLAIMS VOID. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, except as provided in section 204 of this title, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. The provisions of this section shall not apply to payments for rent of post-office quarters made by postmasters to duly authorized agents of the lessors." Title 31, U.S.C.A. Sec. 203.

Respectfully submitted,

WILLIAM FISHER,
EDWARD H. CUSHMAN,
Attorneys for Respondents.

SUPREME COURT OF THE UNITED STATES.

No. 12.—October Term, 1935.

American Surety Company of New York, Petitioner,
vs.
Westinghouse Electric Manufacturing Company, et al., Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[November 11, 1935.]

Mr. Justice Cardozo delivered the opinion of the Court.

A contract for drilling a well at the Naval Air Station at Pensacola, Florida, was made in November, 1930, between Melton J. Gray and the United States Government. It was drawn in the standard form. Payments were to be made in accordance with approved estimates during the progress of the work, but the contracting officer was required to retain 10% of the estimated amount "until final completion and acceptance of all work covered by the contract". The percentage might be reduced in stated contingencies. A bond was to be given for the protection of the Government and of persons supplying labor and materials. If thereafter a surety upon the bond became unacceptable, the contractor was to furnish such additional security as might be required to protect the interests concerned.

The total contract price was $13,133.36. The bond which was executed by the contractor and by the petitioner as surety was in the penal sum of $3,940. The condition was that the principal, *i. e.*, the contractor, should perform the contract in all its terms, and in addition should "promptly make payment to all persons supplying the principal with labor and materials in the prosecution of the work". The additional obligation thus incurred is one exacted by statute. Act of August 13, 1894, c. 280, 28 Stat. 278; Act of February 24, 1905, c. 778, 33 Stat. 811; Act of March 3, 1911, c. 231, § 291, 36 Stat. 1167; 40 U. S. C. § 270. Laborers and materialmen, together with the Government, are obligees or beneficiaries of a bond so given (*Equitable Surety Co.* v. *United States*, 234 U. S. 448; *Illinois Surety Co.* v. *John Davis Co.*, 244 U. S. 376;

Brogan v. *National Surety Co.*, 246 U. S. 257), though the claims, if any, of the Government are to have priority of payment. 40 U. S. C. § 270.

The contractor finished the work required by the contract, but did not make payment to all persons supplying him with labor and materials. Demand was made upon the surety, which paid into court $3,940, the full amount of the penalty, for distribution among the respondents in proportion to their interests. The payment did not satisfy what was owing to them for labor and materials furnished for the well. Thereupon conflicting claims arose to the ten per cent retained by the Government in accordance with the contract. On the one hand, the surety laid claim to this reserved percentage ($2,724.23) by right of subrogation, and also and with greater emphasis by force of a covenant of indemnity received from the principal at the beginning of the work. On the other hand, the reserved percentage was claimed by the respondents on the ground that the effect of the statute, the contract and the bond, when read together, was to make the equity of the surety subordinate to theirs. Out of this equity there grew, as they contended, a right or an interest which, even if not a lien in the strict and proper sense, brought kindred consequences along with it. At least a court of equity would not come to the aid of one whose equity was subordinate until claims superior in equity had been satisfied in full.

By this time Gray was a bankrupt, and a trustee in bankruptcy was in charge of his affairs. The Government turned over the fund to the trustee, who held it to abide the order of the court. No claim to any part of it was put forward by the general creditors or by the trustee in their behalf. The controversy was solely between the materialmen on the one side and the surety on the other. Indeed there is nothing to show that any other creditors than these existed. The District Court, confirming a report of a referee, gave priority to the materialmen and made a decree accordingly. The Court of Appeals for the Fifth Circuit affirmed, one judge dissenting. 75 F. (2d) 377. A writ of certiorari brings the case here.

The materialmen were creditors of the contractor, their standing as such being unchallenged in the record or in argument. The contractor was under a legal duty at the time of his insolvency

to pay their claims in full. This obligation would have been his apart from any bond, the debtor-creditor relation subsisting independently. As to materialmen in that relation, the statute and the bond did not add to the extent of the contractor's obligation, though they made it definite and certain. What their effect would be when applied to materialmen not creditors of the contractor is a question not before us. The obligation of the surety, however, unlike that of the contractor, was created solely by the bond and is limited thereby and by the equities growing out of the suretyship relation. In any suit upon the bond, at least against the surety, the nominated penalty was to be the limit of recovery. Upon payment of that penalty it was to be "relieved", in the words of the statute, "from further liability". 40 U. S. C. § 270.

Liability to pay was ended, but equities growing out of the suretyship relation survived in undiminished force. Acquittance under the bond did not leave the surety at liberty to prove against the assets of the insolvent principal on equal terms with the materialmen, still less to go ahead of them. The settled principles of the law of suretyship forbid that competition. *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 266. A surety who has undertaken to pay the creditors of the principal, though not beyond a stated limit, may not share in the assets of the principal by reason of such payment until the debts thus partially protected have been satisfied in full. This is the rule where the right to a dividend has its basis in the principle of equitable subrogation. "A surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied." *United States* v. *National Surety Co.*, 254 U. S. 73, 76.* If the holding were different, the surety would reduce the protection of the bond to the extent of its dividend in the assets of the debtor. *Jenkins* v. *National Surety Co.*, *supra*. The rule is the same, and for like reasons, where the basis of the claim is the debtor's promise to indemnify, if the debtor is insolvent when the promise is enforced. *Jenkins* v. *National Surety Co.*, *supra*, at pp. 266, 267. Cf. *Springfield National Bank* v. *American Surety Co. of New York*, 7 F. (2d) 44. "Wherever equitable principles are called into play, as they preëminently are

*Cf. Peoples v. Peoples Bros., 254 Fed. 489; Maryland Casualty Co. v. Fouts, 11 F. (2d) 71; McGrath v. Carnegie Trust Co., 221 N. Y. 92, 95.

in determining the rights and liabilities of sureties and in the distribution of insolvents' estates, they likewise forbid the surety to secure by independent contract with the debtor indemnity at the expense of the creditor whose claim he has undertaken to secure." *Jenkins* v. *National Surety Co.*, *supra*, at p. 267. This is surely so unless the contract of indemnity has the effect of a specific lien. In the absence of such a lien the reserved percentages in controversy became assets available to creditors, the respondents along with others, upon the completion of the work to the satisfaction of the Government. Insolvency supervening, the surety must be postponed in the distribution of the assets to the remedies of any claimants who are members of the class of creditors covered by the bond.

The petitioner draws a distinction between a general promise to indemnify, which would be implied if not expressed, and a promise whereby a specific fund, whether in being or to arise thereafter, is set apart or earmarked as collateral security. We are told in effect that the displacement of a lien is an exercise of power more drastic and far-reaching than the marshalling of assets where there has been no agreement for a lien. The distinction might be important if the contest were between the surety and creditors not covered by the bond or between the surety and later assignees of the security so promised. *Prairie State Bank* v. *United States*, 164 U. S. 227; *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404. Such is not the situation here, even though we assume in aid of the petitioner that the promise to indemnify, obscure in its terms, is to be read as amounting to a specific appropriation of the percentages reserved or of any other assets. The contest in this cause is between the surety on the one hand and on the other hand creditors of the class it has undertaken to protect. At such times the position of the surety is not bettered though the promise is directed to particular collateral, at all events where the bond is one required by the law. What considerations may govern after payment of the penalty in full where the bond is altogether a voluntary security we do not need to inquire. Cases such as *Keller* v. *Ashford*, 133 U. S. 610, 622; *Hampton* v. *Phipps*, 108 U. S. 260, 263; and *Moses* v. *Murgatroyd*, 1 Johns. Ch. 119, 129, though they suggest an analogy, do not control, even in principle, for there the surety was in default upon his obligation to the

creditor. Slight differences in the facts may cause the equities to vary, and thus vary the result. What concerns us here is the remedy available where the bond has been given under the mandate of a statute. Equity then forbids that the statutory security be whittled down indirectly by any promise of indemnity, general or specific. Debtor and surety may not effectually agree that materialmen and laborers shall have less of the general assets as the price of their right to recover on the bond. Through the bond and the statute a new relation has been established with a new set of equities, not subject to destruction at the pleasure of the principal. The integrity of that relation is in the keeping of the law.

We have no occasion to consider to what extent the creditors of the bankrupt not covered by the bond are affected by the equities of creditors so covered or by those of the petitioner with the result that their claims are to be held subordinate thereto. Cf. *Prairie State Bank* v. *United States; supra; Henningsen* v. *United States Fidelity & Guaranty Co.; supra.* As we have already pointed out, the record does not show that there are any general creditors, and if any such exist, they are not complaining of the decree. Our decision must be kept within the bounds of the controversy before us.

The decree of the Circuit Court of Appeals is accordingly

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 12.—October Term, 1935.

American Surety Company of New York, Petitioner,
vs.
Westinghouse Electric Manufacturing Company, et al., Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[November 11, 1935.]

Mr. Justice Roberts.

The opinion of Judge Sibley in the court below (75 F. (2d) 380) seems to me conclusive upon the propositions that neither the common law, the contract with the Government, nor the bond furnished by the contractor, give materialmen or laborers any right of lien upon the fund or preference in distribution thereof. I also agree with his view that the indemnity contract between the contractor and the surety company (even if an assignment of a claim for retained percentages against the United States were valid, in view of R. S. § 3477), is too vague to amount to an assignment of the retained percentages; and that the surety is not entitled to subrogation either to the rights of the United States or of the materialmen and contractors. I think it clear that, in the circumstances, the amount paid by the United States into the fund in the hands of the trustee in bankruptcy is general assets of the estate and that the surety company, as respects its claim for the amount paid under its bond, and the furnishers of material and labor, are general creditors entitled to no preference or priority over each other. I think the judgment should, therefore, be reversed.